# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2019**

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission File Number: 000-52024**

# ALPHATEC HOLDINGS, INC.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **20-2463898** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**5818 El Camino Real**

**Carlsbad, CA 92008**

**(Address of principal executive offices, including zip code)**

**(760) 431-9286**

**(Registrant's telephone number, including area code)**

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---|---|---|
| Common stock, par value $.0001 per share | ATEC | The NASDAQ Global Select Market |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated filer | ☐ |
| Non-accelerated filer | ☒ | Smaller reporting company | ☒ |
| Emerging growth company | ☐ | | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ☐ No ☒

As of July 22, 2019, there were 47,656,697 shares of the registrant's common stock outstanding.

**ALPHATEC HOLDINGS, INC.**
**QUARTERLY REPORT ON FORM 10-Q**
**June 30, 2019**

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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements**

### ALPHATEC HOLDINGS, INC.
### CONDENSED CONSOLIDATED BALANCE SHEETS
### (In thousands, except for par value data)

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| **Assets** | (Unaudited) | |
| Current assets: | | |
| Cash | $ 18,570 | $ 29,054 |
| Accounts receivable, net | 13,642 | 15,095 |
| Inventories, net | 32,605 | 28,765 |
| Prepaid expenses and other current assets | 10,904 | 2,030 |
| Withholding tax receivable from officer | — | 350 |
| Current assets of discontinued operations | 225 | 242 |
| Total current assets | 75,946 | 75,536 |
| Property and equipment, net | 15,090 | 13,235 |
| Operating lease right-of-use asset | 2,170 | — |
| Goodwill | 13,897 | 13,897 |
| Intangibles, net | 26,054 | 26,408 |
| Other assets | 222 | 347 |
| Noncurrent assets of discontinued operations | 53 | 54 |
| Total assets | $ 133,432 | $ 129,477 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 8,178 | $ 4,399 |
| Accrued expenses | 20,831 | 22,316 |
| Current portion of long-term debt | 286 | 3,276 |
| Current portion of operating lease liability | 1,173 | — |
| Current liabilities of discontinued operations | 538 | 621 |
| Total current liabilities | 31,006 | 30,612 |
| Long-term debt, less current portion | 49,369 | 42,299 |
| Operating lease liability | 1,467 | — |
| Other long-term liabilities | 13,826 | 15,389 |
| Redeemable preferred stock, $0.0001 par value; 20,000 shares authorized at June 30, 2019 and December 31, 2018; 3,319 shares issued and outstanding at both June 30, 2019 and December 31, 2018 | 23,603 | 23,603 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Series A convertible preferred stock, $0.0001 par value; 15 shares authorized at June 30, 2019 and December 31, 2018; 0 and 4 shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively | — | — |
| Series B convertible preferred stock, $0.0001 par value; 45 shares authorized at June 30, 2019 and December 31, 2018; 0 shares issued and outstanding at June 30, 2019 and December 31, 2018 | — | — |
| Common stock, $0.0001 par value; 200,000 shares authorized at June 30, 2019 and December 31, 2018; 47,635 issued and 47,373 outstanding at June 30, 2019 net of 262 unvested shares and 43,368 shares issued and outstanding at December 31, 2018 | 4 | 4 |
| Treasury stock, at cost, 2 shares, at both June 30, 2019 and December 31, 2018 | (97) | (97) |
| Additional paid-in capital | 545,423 | 523,525 |
| Shareholder note receivable | (5,000) | (5,000) |
| Accumulated other comprehensive income | 1,157 | 1,064 |
| Accumulated deficit | (527,326) | (501,922) |
| Total stockholders' equity | 14,161 | 17,574 |
| Total liabilities and stockholders' equity | $ 133,432 | $ 129,477 |

See accompanying notes to unaudited condensed consolidated financial statements.

**ALPHATEC HOLDINGS, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**
**(UNAUDITED)**

**(In thousands, except per share amounts)**

| | Three Months Ended June 30, 2019 | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|---|---|
| Revenues: | | | | |
| Revenue from U.S. products | $ 26,093 | $ 20,409 | $ 49,048 | $ 39,610 |
| Revenue from international supply agreement | 1,226 | 1,633 | 2,826 | 3,739 |
| Total revenues | 27,319 | 22,042 | 51,874 | 43,349 |
| Cost of revenues | 8,433 | 6,488 | 16,420 | 12,890 |
| Gross profit | 18,886 | 15,554 | 35,454 | 30,459 |
| Operating expenses: | | | | |
| Research and development | 3,360 | 2,009 | 6,829 | 3,795 |
| Sales, general and administrative | 24,568 | 17,538 | 45,568 | 34,795 |
| Litigation-related expenses | 1,200 | 2,234 | 3,823 | 2,814 |
| Amortization of intangible assets | 172 | 187 | 354 | 364 |
| Transaction-related expenses | — | (62) | — | 1,480 |
| Gain on settlement | — | — | — | (6,168) |
| Restructuring expenses | — | 193 | 60 | 591 |
| Total operating expenses | 29,300 | 22,099 | 56,634 | 37,671 |
| Operating loss | (10,414) | (6,545) | (21,180) | (7,212) |
| Total other expense, net | (1,921) | (1,784) | (4,040) | (3,429) |
| Loss from continuing operations before taxes | (12,335) | (8,329) | (25,220) | (10,641) |
| Income tax provision (benefit) | 71 | (1,265) | 102 | (1,723) |
| Loss from continuing operations | (12,406) | (7,064) | (25,322) | (8,918) |
| Loss from discontinued operations, net of applicable taxes | (30) | (12) | (82) | (74) |
| Net loss | $ (12,436) | $ (7,076) | $ (25,404) | $ (8,992) |
| Net loss per share, basic and diluted: | | | | |
| Continuing operations | $ (0.26) | $ (0.21) | $ (0.55) | $ (0.32) |
| Discontinued operations | $ (0.00) | $ (0.00) | $ (0.00) | $ (0.00) |
| Net loss per share, basic and diluted | $ (0.27) | $ (0.21) | $ (0.55) | $ (0.32) |
| Shares used in calculating basic and diluted net loss per share | 46,880 | 34,030 | 45,957 | 27,656 |

See accompanying notes to unaudited condensed consolidated financial statements.

**ALPHATEC HOLDINGS, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**
**(UNAUDITED)**

**(In thousands)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Net loss | $ (12,436) | $ (7,076) | $ (25,404) | $ (8,992) |
| Foreign currency translation adjustments related to continuing operations | 18 | 10 | 93 | (12) |
| Comprehensive loss | $ (12,418) | $ (7,066) | $ (25,311) | $ (9,004) |

See accompanying notes to unaudited condensed consolidated financial statements.

# ALPHATEC HOLDINGS, INC.
## CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
## (UNAUDITED)
## (In thousands)

| | Common stock | | Series A Convertible Preferred Stock | | Series B Convertible Preferred Stock | | Additional paid-in capital | Shareholder note receivable | Treasury stock | Accumulated other comprehensive income (loss) | Accumulated deficit | Total stockholders' equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Par Value | Shares | Par Value | Shares | Par Value | | | | | | |
| **Balance at January 1, 2018** | 19,857 | $ 2 | 5 | $ — | — | $ — | $ 436,803 | $ (5,000) | $ (97) | $ 1,093 | $ (459,459) | $ (26,658) |
| Stock-based compensation | — | — | — | — | — | — | 812 | — | — | — | — | 812 |
| Issuance of Series B preferred stock, net of offering costs of $2.6 million | — | — | — | — | 45 | — | 42,823 | — | — | — | — | 42,823 |
| Common stock issued for conversion of Series A preferred stock | 637 | — | (1) | — | — | — | — | — | — | — | — | — |
| Common stock issued for vesting of restricted stock awards, net of shares repurchased for tax liability | 38 | — | — | — | — | — | — | — | — | — | — | — |
| Common stock issued for warrant exercises | 2,061 | — | — | — | — | | 4,128 | — | — | — | — | 4,128 |
| Issuance of common stock and warrants for the acquisition of SafeOp | 2,975 | — | — | — | — | — | 11,468 | — | — | — | — | 11,468 |
| Prepaid forward contract for the additional shares to be issued for the acquisition of SafeOp | — | — | — | — | — | — | 938 | — | — | — | — | 938 |
| Foreign currency translation adjustments | — | — | — | — | — | — | — | — | — | (22) | — | (22) |
| Net loss | | | — | | — | | | | | | (1,916) | (1,916) |
| **Balance at March 31, 2018** | 25,568 | 2 | 4 | — | 45 | — | 496,972 | (5,000) | (97) | 1,071 | (461,375) | 31,573 |
| Stock-based compensation | — | — | — | — | — | — | 1,222 | — | — | — | — | 1,222 |
| Conversion of Series B preferred stock | — | — | — | — | (45) | — | (42,823) | — | — | — | — | (42,823) |
| Common stock issued for conversion of Series B preferred stock | 14,349 | 2 | — | — | — | — | 42,822 | — | — | — | — | 42,824 |
| Common stock issued for vesting of restricted stock awards, net of shares repurchased for tax liability | 28 | — | — | — | — | — | — | — | — | — | — | — |
| Common stock issued for warrant exercises | 2,250 | — | — | — | — | | 4,500 | — | — | — | — | 4,500 |
| Issuance of common stock for the acquisition of SafeOp | 116 | — | — | — | — | — | 364 | — | — | — | — | 364 |
| Prepaid forward contract for the additional shares to be issued for the acquisition of SafeOp | — | — | — | — | — | — | (460) | — | — | — | — | (460) |
| Common stock issued for employee stock purchase plan and stock option exercises | 90 | — | — | — | — | — | 260 | — | — | — | — | 260 |
| Series B issuance costs | — | — | — | — | — | — | (174) | — | — | — | — | (174) |
| Foreign currency translation adjustments | — | — | — | — | — | — | — | — | — | 10 | — | 10 |
| Net loss | | | — | | — | | | | | | (7,076) | (7,076) |
| **Balance at June 30, 2018** | 42,401 | $ 4 | 4 | $ — | — | $ — | $ 502,683 | $ (5,000) | $ (97) | $ 1,081 | $ (468,451) | $ 30,220 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance at January 1, 2019** | 43,368 | $ 4 | 4 | $ — | — | $ — | $ 523,525 | $ (5,000) | $ (97) | $ 1,064 | $ (501,922) | $ 17,574 |
| Stock-based compensation | — | — | — | — | — | — | 1,565 | — | — | — | — | 1,565 |
| Distributor equity incentives | 15 | — | — | — | — | — | 42 | — | — | — | — | 42 |
| Common stock issued for conversion of Series A preferred stock | 1,858 | — | (4) | — | — | — | — | — | — | — | — | — |
| Recognition of beneficial conversion feature - SafeOp Convertible Notes | | | | | | | 242 | | | | — | 242 |
| Common stock issued for stock option exercises | 8 | — | — | — | — | — | 14 | — | — | — | — | 14 |
| Common stock issued for vesting of restricted stock awards, net of shares repurchased for tax liability | 442 | — | — | — | — | — | (183) | — | — | — | — | (183) |
| Issuance of common stock for acquisition of SafeOp - Milestone 2 | 887 | — | — | — | — | — | 2,889 | — | — | — | — | 2,889 |
| Foreign currency translation adjustments | — | — | — | — | — | — | — | — | — | 75 | — | 75 |
| Net loss | | | — | | — | | | | | | (12,968) | (12,968) |
| **Balance at March 31, 2019** | 46,578 | 4 | — | — | — | — | 528,094 | (5,000) | (97) | 1,139 | (514,890) | 9,250 |
| Stock-based compensation | — | — | — | — | — | — | 2,140 | — | — | — | — | 2,140 |
| Distributor equity incentives | 45 | — | — | — | — | — | 138 | — | — | — | — | 138 |
| Common stock issued for warrant exercises | 255 | — | — | — | — | — | 723 | — | — | — | — | 723 |
| Common stock issued for employee stock purchase plan and stock option exercises | 278 | — | — | — | — | — | 664 | — | — | — | — | 664 |
| Common stock issued for vesting of restricted stock awards, net of shares repurchased for tax liability | 217 | — | — | — | — | — | — | — | — | — | — | — |
| Issuance of common stock warrants | — | — | — | — | — | — | 13,664 | — | — | — | — | 13,664 |
| Foreign currency translation adjustments | — | — | — | — | — | — | — | — | — | 18 | — | 18 |
| Net loss | | | — | | — | | | | | | (12,436) | (12,436) |
| **Balance at June 30, 2019** | 47,373 | $ 4 | — | $ — | — | $ — | $ 545,423 | $ (5,000) | $ (97) | $ 1,157 | $ (527,326) | $ 14,161 |

See accompanying notes to unaudited condensed consolidated financial statements

**ALPHATEC HOLDINGS, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(UNAUDITED)**
**(In thousands)**

| | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|
| **Operating activities:** | | |
| Net loss | $ (25,404) | $ (8,992) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 3,430 | 3,475 |
| Stock-based compensation | 3,963 | 1,767 |
| Amortization of debt discount and debt issuance costs | 1,033 | 1,090 |
| Amortization of right-of-use asset | 441 | — |
| Provision for doubtful accounts | 122 | 110 |
| Provision for excess and obsolete inventory | 4,123 | 2,212 |
| Deferred income tax benefit | 2 | (1,238) |
| Gain on settlement | — | (6,168) |
| Beneficial conversion feature from convertible notes | 242 | — |
| Gain (loss) on disposal of instruments | 66 | (285) |
| Accretion to contingent consideration | 289 | 100 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 1,330 | 3,346 |
| Inventories, net | (7,963) | (2,905) |
| Prepaid expenses and other current assets | 285 | 49 |
| Other assets | 126 | (55) |
| Other long-term assets | (2,690) | — |
| Accounts payable | 4,322 | (620) |
| Accrued expenses and other | 1,201 | 1,768 |
| Lease liability | 2,639 | — |
| Other long-term liabilities | (2,199) | (2,365) |
| Net cash used in operating activities | (14,642) | (8,711) |
| **Investing activities:** | | |
| Purchases of property and equipment | (3,717) | (2,387) |
| Cash paid for acquisition of SafeOp Surgical, Inc. | — | (14,344) |
| Cash received from sale of equipment | — | 348 |
| Net cash used in investing activities | (3,717) | (16,383) |
| **Financing activities:** | | |
| Proceeds from sale of common stock, net | 1,401 | 51,538 |
| Borrowings under lines of credit | 54,220 | 44,500 |
| Repayments under lines of credit | (54,488) | (46,634) |
| Principal payments on capital lease obligations | (12) | (60) |
| Proceeds from issuance of term debt, net | 9,700 | — |
| Principal payments on term loan | (3,045) | (1,800) |
| Net cash provided by financing activities | 7,776 | 47,544 |
| Effect of exchange rate changes on cash | 99 | (4) |
| Net increase (decrease) in cash | (10,484) | 22,446 |
| Cash at beginning of period, including discontinued operations | 29,054 | 22,466 |
| Cash at end of period, including discontinued operations | $ 18,570 | $ 44,912 |
| **Supplemental disclosure of cash flow information:** | | |
| Cash paid for interest | $ 2,714 | $ 2,282 |
| Cash paid for income taxes | $ 102 | $ 72 |
| Purchases of property and equipment in accounts payable | $ 2,221 | $ 531 |
| Common stock warrants issued with term loan draw | $ 13,664 | $ — |
| Common stock issued for achievement of SafeOp contingent consideration | $ 2,889 | $ — |

See accompanying notes to unaudited condensed consolidated financial statements.

**ALPHATEC HOLDINGS, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. The Company and Basis of Presentation**

***The Company***

Alphatec Holdings, Inc. (the “Company”), through its wholly owned subsidiaries, Alphatec Spine, Inc. (“Alphatec Spine”) and SafeOp Surgical, Inc. (“SafeOp”), is a medical technology company that designs, develops, and markets spinal fusion technology products and solutions for the treatment of spinal disorders associated with disease and degeneration, congenital deformities, and trauma. The Company markets its products in the U.S. via independent sales agents and a direct sales force.

On March 8, 2018, the Company completed its acquisition of SafeOp, a Delaware corporation, pursuant to a reverse triangular merger of SafeOp into a newly-created wholly-owned subsidiary of the Company, with SafeOp being the surviving corporation and a wholly-owned subsidiary of the Company. See Note 8 for further information.

On September 1, 2016, the Company completed the sale of its international distribution operations and agreements (collectively, the “International Business”) to Globus Medical Ireland, Ltd., a subsidiary of Globus Medical, Inc., and its affiliated entities (collectively “Globus”). As a result of this transaction, the International Business has been excluded from continuing operations for all periods presented in this Quarterly Report on Form 10-Q and is reported as discontinued operations. See Note 4 for additional information on the divestiture of the International Business.

***Basis of Presentation***

The accompanying condensed consolidated balance sheet as of December 31, 2018, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements have been prepared by the Company in accordance with U.S. generally accepted accounting principles (“GAAP”) and the rules and regulations of the Securities and Exchange Commission (“SEC”) related to a quarterly report on Form 10-Q. Certain information and note disclosures normally included in annual audited financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made in this Quarterly Report on Form 10-Q are adequate to make the information not misleading. The unaudited interim condensed consolidated financial statements reflect all adjustments, including normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the financial position and results of operations for the periods presented. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2018, which are included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 that was filed with the SEC on March 29, 2019. Operating results for the three and six months ended June 30, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019, or any other future periods.

***Liquidity***

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern and do not include any adjustments that might result from the outcome of this uncertainty. A going concern basis of accounting contemplates the recovery of the Company’s assets and the satisfaction of its liabilities in the normal course of business.

The Company’s annual operating plan projects that its existing working capital at June 30, 2019 of $44.9 million (including cash of $18.6 million) along with the use of the Expanded Credit Facility with Squadron Medical Finance Solutions LLC (“Squadron”) of the remaining $20.0 million that closed on March 27, 2019 allows the Company to fund its operations through at least one year subsequent to the date the financial statements are issued.

The Company has incurred significant net losses since inception and has relied on its ability to fund its operations through revenues from the sale of its products, equity financings and debt financings. As the Company has historically incurred losses, successful transition to profitability is dependent upon achieving a level of revenues adequate to support the Company’s cost structure. This may not occur and, unless and until it does, the Company will continue to need to raise additional capital. Operating losses and negative cash flows may continue for at least the next year as the Company continues to incur costs related to the execution of its operating plan and introduction of new products. The Company’s inability to raise additional capital from outside sources will have a material adverse impact on its operations.

As more fully described in Note 5, the Company's debt agreements include traditional lending and reporting covenants, including a financial covenant that requires the Company to maintain a minimum fixed charge coverage ratio beginning in April 2020 and a minimum liquidity covenant of $5.0 million effective through March 2020. Should at any time the Company fail to maintain compliance with these covenants, the Company will need to seek waivers or amendments to the debt agreements. If the Company is unable to secure such waivers or amendments, it may be required to classify its obligations under the debt agreements in current liabilities on its consolidated balance sheet. The Company may also be required to repay all or a portion of outstanding indebtedness under the debt agreements, which would require the Company to obtain further financing. There is no assurance that the Company will be able to obtain further financing, or do so on reasonable terms.

***Reclassification***

Certain amounts in the condensed consolidated statement of operations for the three and six months ended June 30, 2018 have been reclassified to conform to the current period's presentation. These reclassifications include the depreciation expense for surgical instruments, which was reclassified, to be consistent with industry practice, out of cost of revenues and into sales, general and administrative expense on the Company's consolidated statements of operations. This resulted in a reclassification of $1.3 million and $2.6 million of depreciation expense for the three and six months ended June 30, 2018, respectively. In addition, general and administrative expense for 2018 was combined into a single line item with sales and marketing expense for a new expense line titled "Sales, general and administrative expense" and litigation-related expenses primarily pertaining to the ongoing litigation with NuVasive, Inc. were classified out of selling, general and administrative expense on the Company's consolidated statement of operations for the three and six months ended June 30, 2018 and onto its own expense line item. None of the adjustments had any effect on the prior period net loss.

**2. Summary of Significant Accounting Policies**

The Company's significant accounting policies are described in Note 2 to its audited consolidated financial statements for the year ended December 31, 2018, which are included in the Company's Annual Report on Form 10-K that was filed with the SEC on March 29, 2019. Except as discussed below, these accounting policies have not changed during the three and six months ended June 30, 2019.

***Operating Lease***

Effective January 1, 2019, the Company adopted ASC No. 2016-02, Leases (Topic 842) ("ASU 2016-02" or "ASC 842"), which supersedes the current accounting for leases, using the modified retrospective transition method. The Company has elected to apply the practical expedients allowed by the standard for existing leases. The new standard, while retaining two distinct types of leases, finance and operating, (i) requires lessees to record a right-of-use ("ROU")asset and a related liability for the rights and obligations associated with a lease, regardless of lease classification, and recognize lease expense in a manner similar to current accounting, (ii) eliminates current real estate specific lease provisions, (iii) modifies the lease classification criteria and (iv) aligns many of the underlying lessor model principles with those in the new revenue standard. The Company determines the initial classification and measurement of its ROU asset and lease liabilities at the lease commencement date and thereafter, if modified. The Company recognizes a ROU asset for its operating leases with lease terms greater than 12 months. The lease term includes any renewal options and termination options that the Company is reasonably assured to exercise. The present value of lease payments is determined by using the incremental borrowing rate for operating leases determined by using the incremental borrowing rate of interest that the Company would pay to borrow on a collateralized basis an amount equal to the lease payments in a similar economic environment. The Company applied the new guidance to its existing facility lease at the time of adoption and recognized a ROU asset of $2.4 million and operating lease liability of $2.9 million as of March 31, 2019, the initial period of adoption, and removed the previous deferred rent balance under the previous lease guidance of approximately $0.6 million.

Rent expense for operating leases is recognized on a straight-line basis over the reasonably assured lease term based on the total lease payments and is included in research and development and general and administrative expenses in the statements of operations.

***Beneficial Conversion Feature – SafeOp Convertible Notes***

In March 2019, the Company's Convertible Note outstanding reached maturity and allowed for the noteholders to elect settlement in cash or shares of common stock. As the Convertible Note provided the holders the benefit to convert to shares of common stock, a beneficial conversion feature ("BCF") with a calculated intrinsic fair value at issuance of $0.2 million existed as of the date the Convertible Note was able to be converted into shares of common stock. Although the holders elected for cash settlement, the BCF was required to be recognized as interest expense on the Company's consolidated statement of operations and within additional paid-in-capital within the Company's condensed consolidated statement of stockholders' equity for the six months ended June 30, 2019.

***Fair Value Measurements***

The carrying amount of financial instruments consisting of cash, restricted cash, trade accounts receivable, prepaid expenses and other current assets, accounts payable, accrued expenses, accrued compensation and current portion of long-term debt included in the Company's consolidated financial statements are reasonable estimates of fair value due to their short maturities. Based on the borrowing rates currently available to the Company for loans with similar terms, management believes the fair value of long-term debt approximates its carrying value.

Authoritative guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1:Observable inputs such as quoted prices in active markets;

Level 2:Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3:Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The Company does not maintain any financial assets that are considered to be Level 1, Level 2 or Level 3 instruments as of June 30, 2019. The fair value of the contingent consideration liability assumed in the SafeOp acquisition was recorded as part of the purchase price consideration of the acquisition. The contingent consideration related to the SafeOp acquisition was classified within Level 3 of the fair value hierarchy as the Company was using a probability-weighted income approach, utilizing significant unobservable inputs including the probability of achieving each of the potential milestones and an estimated discount rate related to the risks of the expected cash flows attributable to the milestones. All the contingent milestones were achieved as of June 30, 2019. During the three months ended June 30, 2019, the Company issued a liability classified equity award to one of its executive officers. The award will be earned over a 4 year vesting period and upon a specific market condition. As the award will be cash settled, it is classified as a liability within Level 3 of the fair value hierarchy as the Company is using a probability-weighted income approach, utilizing significant unobservable inputs including the probability of achieving the specified market condition.

The following table provides a reconciliation of liabilities measured at fair value using significant unobservable inputs (Level 3) for the six months ended June 30, 2019 (in thousands):

| | | Level 3 Liabilities |
|---|---|---|
| Balance at January 1, 2019 | $ | 2,600 |
| Settlement of Milestone #2 | | (2,889) |
| Change in fair value measurement | | 289 |
| Balance at March 31, 2019 | | — |
| Vested portion of liability classified equity award | | 31 |
| Balance at June 30, 2019 | $ | 31 |

During the six months ended June 30, 2019, the Company achieved the second of the two milestones which was settled through the issuance of 886,843 shares of the Company's common stock. See Note 8 for further information.

***Recent Accounting Pronouncements***

*Recently Adopted Accounting Pronouncements*

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02*, Leases (Topic 842)*, which changes several aspects of the accounting for leases, including the requirement that all leases with durations greater than twelve months be recognized on the balance sheet. The guidance is effective for annual and interim reporting periods in fiscal years beginning after December 15, 2018. The Company adopted the guidance effective January 1, 2019 and elected the optional transition method to account for the impact of the adoption with a cumulative-effect adjustment in the period of adoption and did not restate prior periods. The Company elected certain practical expedients permitted under the transition guidance. As part of the adoption, the Company recorded a ROU asset and liability upon adoption of the guidance pertaining to its long-term real estate lease for its corporate facilities. No cumulative-effect adjustment was needed.

*Recently Issued Accounting Pronouncements*

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other*, which eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value. The standard has tiered effective dates, starting in 2020 for calendar-year public business entities that meet the definition of an SEC filer. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The Company is in the process of determining the impacts the adoption will have on its consolidated financial statements as well as whether to early adopt the new guidance.

### 3. Select Condensed Consolidated Balance Sheet Details

***Accounts Receivable, net***

Accounts receivable, net consist of the following (in thousands):

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Accounts receivable | $ 13,938 | $ 15,291 |
| Allowance for doubtful accounts | (296) | (196) |
| Accounts receivable, net | $ 13,642 | $ 15,095 |

***Inventories, net***

Inventories, net consist of the following (in thousands):

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Raw materials | $ 6,071 | $ 5,813 |
| Work-in-process | 814 | 952 |
| Finished goods | 46,615 | 39,758 |
| | 53,500 | 46,523 |
| Less reserve for excess and obsolete finished goods | (20,895) | (17,758) |
| Inventories, net | $ 32,605 | $ 28,765 |

***Property and Equipment, net***

Property and equipment, net consist of the following (in thousands except as indicated):

| | Useful lives (in years) | June 30, 2019 | December 31, 2018 |
|---|---|---|---|
| Surgical instruments | 4 | $ 54,584 | $ 54,848 |
| Machinery and equipment | 7 | 6,003 | 5,971 |
| Computer equipment | 3 | 3,391 | 3,104 |
| Office furniture and equipment | 5 | 1,244 | 1,155 |
| Leasehold improvements | various | 1,761 | 1,765 |
| Construction in progress | n/a | 145 | 92 |
| | | 67,128 | 66,935 |
| Less accumulated depreciation and amortization | | (52,038) | (53,700) |
| Property and equipment, net | | $ 15,090 | $ 13,235 |

Total depreciation expense was $1.5 million for both the three months ended June 30, 2019 and 2018 and $3.1 million and $3.0 million for the six months ended June 30, 2019 and 2018, respectively. At both June 30, 2019 and December 31, 2018, assets recorded under capital leases of $0.1 million were included in the machinery and equipment balance. Amortization of assets under capital leases is included in depreciation expense.

***Intangible Assets, net***

Intangible assets, net consist of the following (in thousands, except as indicated):

| | Remaining Avg. Useful lives (in years) | June 30, 2019 | December 31, 2018 |
|---|---|---|---|
| Developed technology | 10 | $ 26,976 | $ 26,976 |
| Intellectual property | — | 1,004 | 1,004 |
| License agreements | 1 | 5,536 | 5,536 |
| Trademarks and trade names | — | 792 | 792 |
| Customer-related | 4 | 7,458 | 7,458 |
| Distribution network | 3 | 4,027 | 4,027 |
| In process research and development | 19 | 8,800 | 8,800 |
| | | 54,593 | 54,593 |
| Less accumulated amortization | | (28,539) | (28,185) |
| Intangible assets, net | | $ 26,054 | $ 26,408 |

Total amortization expense was $0.2 million and $0.1 million for the three months ended June 30, 2019 and 2018, respectively and $0.4 million for both the six months ended June 30, 2019 and 2018.

Developed technology and in process research and development intangibles are expected to begin amortizing when the relevant products reach full commercial launch. Future amortization expense related to intangible assets as of June 30, 2019 is as follows (in thousands):

| Year Ending December 31, | |
|---|---|
| Remainder of 2019 | $ 899 |
| 2020 | 1,870 |
| 2021 | 1,890 |
| 2022 | 1,890 |
| 2023 | 1,890 |
| Thereafter | 17,615 |
| | $ 26,054 |

***Accrued Expenses***

Accrued expenses consist of the following (in thousands):

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Commissions and sales milestones | $ 4,337 | $ 3,594 |
| Payroll and payroll related | 4,904 | 3,222 |
| Litigation settlement obligation | 4,400 | 4,400 |
| Professional fees | 2,626 | 2,637 |
| Royalties | 1,609 | 1,354 |
| Restructuring and severance accruals | 140 | 710 |
| Taxes | 3 | (3) |
| Interest | 136 | 261 |
| Acquisition related - contingent consideration | - | 2,600 |
| Other | 2,676 | 3,541 |
| Total accrued expenses | $ 20,831 | $ 22,316 |

**4. Discontinued Operations**

In connection with the sale of the International Business, the Company entered into a product manufacture and supply agreement (the “Supply Agreement”) with Globus, pursuant to which the Company supplies to Globus certain of its implants and instruments (the “Products”), previously offered for sale by the Company in international markets at agreed-upon prices for a minimum term of three years, with the option for Globus to extend the term for up to two additional twelve month periods subject to Globus meeting specified purchase requirements. During the first quarter of 2019, Globus notified the Company that it will exercise the option to extend the agreement an additional twelve months through August 2020. In accordance with authoritative guidance, sales to Globus are reported under continuing operations as the Company has continuing involvement under the Supply Agreement.

The Company recorded $1.2 million in revenue and $1.2 million in cost of revenue from the Supply Agreement in continuing operations for the three months ended June 30, 2019, and $2.8 million in revenue and $2.6 million in cost of revenue for the six months ended June 30, 2019. Included in the results of continuing operations for the three months ended June 30, 2018 is $1.6 million in revenue and $1.5 million in cost of revenue from the Supply Agreement and $3.7 million in revenue and $3.5 million in cost of revenue for the six months ended June 30, 2018. Sales, general and administrative expense pertaining to discontinued operations on the Company's condensed consolidated statements of operations were immaterial for the three and six months ended June 30, 2019 and 2018.

**5. Debt**

***MidCap Facility Agreement***

The Company's Amended Credit Facility with MidCap provides for a revolving credit commitment up to $22.5 million and provided for a term loan commitment up to $5 million. As of June 30, 2019, $10.7 million was outstanding under the revolving line of credit. The principal balance outstanding under the revolving line of credit is due in December 2022.

Amounts outstanding under the revolving line of credit accrue interest at the London Interbank Offered Rate ("LIBOR") plus 6.0%, reset monthly. At June 30, 2019, the revolving line of credit carried an interest rate of 8.44%, with interest payable monthly. The borrowing base is determined based on the value of domestic eligible accounts receivable. As collateral for the Amended Credit Facility, MidCap has a first lien security interest in accounts receivable and a second lien on substantially all other assets.

At June 30, 2019, $1.1 million remains as an unamortized debt discount related to the Amended Credit Facility on the condensed consolidated balance sheet, which will be amortized over the remaining term of the Amended Credit Facility.

***Squadron Credit Agreement***

On November 6, 2018, the Company closed a $35 million Term Loan with Squadron, a provider of debt financing to growing companies in the orthopedic industry. Net proceeds of approximately $34.1 million were used to retire the Company's existing $29.2 million term debt with Globus, with the remainder of the proceeds used for general corporate purposes.

The debt has a five-year maturity and bears interest at LIBOR plus 8% (10.5% as of June 30, 2019) per annum. The credit agreement specifies a minimum interest rate of 10% and a maximum of 13% per year. Interest-only payments are due monthly through May 2021, followed by $10 million in principal payable in 29 equal monthly installments beginning June 2021 and a lump-sum payment payable at maturity in November 2023. As collateral for the Term Loan, Squadron has a first lien security interest in substantially all assets except for accounts receivable.

In connection with the financing, the Company issued initial warrants to Squadron to purchase 845,000 shares of common stock at an exercise price of $3.15 per share. The warrants have a seven-year term and are immediately exercisable.

In March 2019, the Company closed on an expanded credit facility with Squadron for up to $30 million in additional secured financing. This additional financing has been made available under the Company's existing credit facility with Squadron. The Company accounted for the amendment as a debt modification with continued amortization of the existing and inclusion of the new debt issuance costs of $0.3 million amortized into interest expense utilizing the effective interest rate method. The Company took a draw of $10.0 million of the expanded credit facility in June 2019 to be used for general corporate purposes. The additional borrowings under the credit facility will mature concurrent with the current secured financing from Squadron and bear interest at the same rate and subject to the same 10% floor and 13% ceiling. Interest-only payments are due monthly through May 2021, followed by principal payable in 29 equal monthly installments beginning June 2021 and a lump-sum payment payable at maturity in November 2023. In conjunction with the first draw under the expanded credit facility, the Company issued to Squadron warrants to purchase 4,838,710 shares of the Company's common stock at an exercise price of $2.17 per share. The warrants have a seven-year term and are immediately exercisable. The warrants were valued utilizing the Monte-Carlo simulation model as described further in Note 10 and are recorded within equity in accordance with authoritative accounting guidance and with a proportional amount, calculated by taking the draw amount divided by the total expanded credit facility, recorded as a debt discount. The total debt discount will be amortized into interest expense through maturity of the debt utilizing the effective interest rate method. No additional warrants will be issued upon any future draws. The value of the additional warrants issued that are allocated to the remaining balance available for draw on the expanded credit facility were recorded as a deferred cost asset within prepaid and other assets on the consolidated balance sheet as of June 30, 2019 and are being amortized into interest expense on a ratable basis over the term of the debt.

As of June 30, 2019, the debt is recorded at its carrying value of $37.9 million, net of issuance costs of $7.1 million, including all amounts paid to third parties to secure the debt and the fair value of the warrants issued. The debt issuance costs are being amortized into interest expense over the five-year term utilizing the effective interest rate method. The total principal outstanding under the Term Loan as of June 30, 2019 is $45.0 million.

***Inventory Financing***

The Company has an Inventory Financing Agreement with a key inventory and instrument components supplier whereby the Company may draw up to $3.0 million for the purchase of inventory to accrue interest at a rate of LIBOR plus 8% subject to the same 10% floor and 13% ceiling. All principal will become due and payable upon maturity on November 6, 2023 and all interest will be paid monthly. The obligation outstanding under the Inventory Financing Agreement as of June 30, 2019 was $1.8 million.

Principal payments remaining on the Company's debt were as follows as of June 30, 2019 (in thousands):

| **Year Ending December 31,** | | |
|---|---|---|
| Remainder of 2019 | $ | 209 |
| 2020 | | 47 |
| 2021 | | 4,483 |
| 2022 | | 18,428 |
| 2023 | | 34,657 |
| Total | | 57,824 |
| Add: capital lease principal payments | | 114 |
| Less: unamortized debt discount and debt issuance costs | | (8,283) |
| Total | | 49,655 |
| Less: current portion of long-term debt | | (286) |
| Long-term debt, net of current portion | $ | 49,369 |

***Covenants***

The Company's various credit agreements include several event of default provisions, such as payment default, insolvency conditions and a material adverse effect clause, which could cause interest to be charged at a rate which is up to five percentage points above the rate effective immediately before the event of default or result in the lenders' right to declare all outstanding obligations immediately due and payable. Furthermore, the credit agreements contain various covenants, including monthly compliance certifications and compliance with government regulations and maintenance of insurance, and prohibitions against certain specified actions, including acquiring any new equipment financings over a specified amount. The credit agreements also contain various negative covenants including a $5 million minimum liquidity requirement through March 31, 2020. The minimum liquidity covenant will be replaced by a fixed charge ratio, pursuant to which operating cash to fixed charges (as defined) must equal at least 1:1 on a rolling 12-month basis, beginning April 2020. The Company was in compliance with the covenants under the credit agreement at June 30, 2019.

## 6. Commitments and Contingencies

### *Capital Lease*

The Company has one outstanding capital lease arrangement for the lease of equipment as of June 30, 2019 that matures in 2022. The lease bears interest at a rate of 6.40% per annum, is due in monthly principal and interest installments and is collateralized by the related equipment. The total capital lease commitment outstanding as of June 30, 2019 and December 31, 2018 was $0.1 million in both periods.

### *Operating Lease*

The Company leases its buildings and certain equipment under operating leases which expire on various dates through 2021. Upon the Company's adoption of ASC 842 as of January 1, 2019, the Company recognized a ROU asset and lease liability for its building lease, assuming a 10.5% discount rate. Any short-term leases defined as 12 months or less or month-to-month leases were excluded and continue to be expensed each month. Total costs associated with these leases for the three and six months ended June 30, 2019 was immaterial.

The Company determines if an arrangement is a lease at inception. The Company has operating leases for its buildings and certain equipment with lease terms of one year to 5.5 years, some of which include options to extend and/or terminate the lease. The exercise of lease renewal options is at the Company's sole discretion and were not included in the calculation of the Company's lease liability as the Company is not able to determine without uncertainty if the renewal option will be exercised. The depreciable life of assets and leasehold improvements are limited to the expected term, unless there is a transfer of title or purchase option reasonably certain of exercise. The Company's lease agreements do not contain any variable lease payments, residual value guarantees or any restrictive covenants.

The Company's ROU asset represents the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date of the lease or the ASC 842 adoption date, whichever is later, based on the present value of lease payments over the lease term. When readily determinable, the Company uses the implicit rate in determining the present value of lease payments, or 10.5% as of the adoption date. When leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the lease commencement date or adoption date, including the lease term. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

Future minimum annual lease payments under such leases are as follows as of June 30, 2019 (in thousands):

| | | |
|---|---|---|
| Undiscounted lease payments: | | |
| **Year Ending December 31,** | | |
| Remainder of 2019 | $ | 689 |
| 2020 | | 1,416 |
| 2021 | | 849 |
| Total undiscounted lease payments | | 2,954 |
| Less: present value adjustment | | (314) |
| Operating lease liability | | 2,640 |
| Less: current portion of operating lease liability | | (1,173) |
| Operating lease liability, less current portion | $ | 1,467 |

As of June 30, 2019, the Company's remaining lease term is 2.0 years. Rent expense under operating leases for the three months ended June 30, 2019 and 2018 was $0.4 million for both periods and $0.7 million and $0.6 million for the six months ended June 30, 2019 and 2018, respectively. The Company paid $0.3 million and $0.7 million of cash payments related to its operating lease agreement for the three and six months ended June 30, 2019, respectively.

### *Litigation*

The Company is and may become involved in various legal proceedings arising from its business activities. While management is not aware of any litigation matter that in and of itself would have a material adverse impact on the Company's consolidated results of operations, cash flows or financial position, litigation is inherently unpredictable, and depending on the nature and timing of a proceeding, an unfavorable resolution could materially affect the Company's future consolidated results of operations, cash flows or financial position in a particular period. The Company assesses contingencies to determine the degree of probability and range of possible loss for potential accrual or disclosure in the Company's consolidated financial statements. An estimated loss contingency is accrued in the Company's consolidated financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgments about future events. When evaluating contingencies, the Company may be unable to provide a meaningful estimate due to a number of factors, including the procedural status of the matter in question, the presence of complex or novel legal theories, and/or the ongoing discovery and development of information important to the matters. In addition, damage amounts claimed in litigation against the Company may be unsupported, exaggerated or unrelated to reasonably possible outcomes, and as such are not meaningful indicators of the Company's potential liability.

On February 13, 2018, NuVasive, Inc. filed suit against the Company in the United States District Court for the Southern District of California, alleging that certain of the Company's products (including components of the Battalion™ Lateral System), infringe, or contribute to the infringement of, U.S. Patent Nos. 7,819,801, 8,355,780, 8,439,832, 8,753,270, 9,833,227 (entitled "Surgical access system and related methods"), U.S. Patent No. 8,361,156 (entitled "Systems and methods for spinal fusion"), and U.S. Design Patent Nos. D652,519 ("Dilator") and D750,252 ("Intervertebral Implant"). NuVasive is seeking unspecified monetary damages and a court injunction against future infringement by the Company.

On March 8, 2018, the Company moved to dismiss NuVasive's claims of infringement of its design patents on the grounds that those allegations fail to state a cognizable legal claim. On May 14, 2018, the Court ruled that NuVasive had failed to state a plausible claim for infringement of the asserted design patents and granted the Company's motion to dismiss those claims with prejudice, as any further amendment would be futile. The Company filed its answer, affirmative defenses and counterclaims to NuVasive's remaining claims on May 21, 2018.

On March 26, 2018, NuVasive moved for a preliminary injunction, which, on March 27, 2018, the Court denied without prejudice for failure to comply with the Court's chambers rules. On April 5, 2018, NuVasive again moved for a preliminary injunction. The Court held a hearing on the matter, having been fully briefed, on June 21, 2018. On July 10, 2018, the Court ruled that NuVasive had failed to establish either likelihood of success on the merits of its remaining claims or that it would suffer irreparable harm in the absence of a preliminary injunction. Accordingly, the Court denied NuVasive's motion for preliminary injunction.

On September 13, 2018, NuVasive filed an Amended Complaint for Patent Infringement, asserting additional infringement claims of U.S. Patent Nos. 9,924,859, 9,974,531 and 8,187,334. The Company filed its answer, affirmative defenses and counterclaims to NuVasive's claims on October 12, 2018. On October 26, 2018, NuVasive moved to dismiss the Company's counterclaims that NuVasive intentionally had misled the U.S. Patent and Trademark Office as a means of obtaining certain patents asserted against the Company. On January 30, 2019, the Court denied NuVasive's motion as to all but one of the Company's counterclaims. The Court granted NuVasive's motion with respect to one counterclaim, but granted the Company leave to amend its counterclaim to cure the dismissal. The Company amended that counterclaim on February 14, 2019. On February 28, 2019, NuVasive moved to dismiss the amended counterclaim. On March 29, 2019, the Court denied NuVasive's motion. NuVasive filed its Answer to the amended counterclaim on April 12, 2019.

On December 13, 2018, the Company filed a petition with the Patent Trial and Appeal Board ("PTAB") challenging the validity of certain claims of U.S. Patent No. 8,361,156. On December 21, 2018, the Company filed a similar petition with PTAB challenging the validity of certain claims of U.S. Patent No. 8,187,334. On February 6, 2019, upon joint motion of the parties, the Court stayed all proceedings in this matter, except as noted above, pending PTAB's determination of whether to institute *inter partes* review of the asserted claims of the two patents at issue and vacated the trial date. On July 9, 2019, PTAB instituted *inter partes* review of the validity of asserted claims of the two patents at issue. The Company expects PTAB to issue its final decisions regarding the validity of these claims in the second half of 2020. On July 16, 2019, the parties submitted a joint statement to the Court regarding PTAB's decisions and the parties' respective recommendations regarding the current stay of proceedings. The Court has not yet ruled on continuation of the stay of proceedings.

The Company believes that the allegations lack merit and intends to vigorously defend all claims asserted. It is impossible at this time to assess whether the outcome of this proceeding will have a material adverse effect on the Company's consolidated results of operations, cash flows or financial position. Therefore, in accordance with authoritative accounting guidance, the Company has not recorded any accrual for a contingent liability associated with this legal proceeding based on its belief that a liability, while possible, is not probable and any range of potential future charge cannot be reasonably estimated at this time.

***Indemnifications***

In the normal course of business, the Company enters into agreements under which it occasionally indemnifies third-parties for intellectual property infringement claims or claims arising from breaches of representations or warranties. In addition, from time to time, the Company provides indemnity protection to third-parties for claims relating to past performance arising from undisclosed liabilities, product liabilities, environmental obligations, representations and warranties, and other claims. In these agreements, the scope and amount of remedy, or the period in which claims can be made, may be limited. It is not possible to determine the maximum potential amount of future payments, if any, due under these indemnities due to the conditional nature of the obligations and the unique facts and circumstances involved in each agreement.

In October 2017, NuVasive filed a lawsuit in Delaware Chancery Court against Mr. Miles, the Company's Chairman and CEO, who was a former officer and board member of NuVasive. The Company itself was not initially a named defendant in this lawsuit; however, on June 28, 2018, NuVasive amended its complaint to add the Company as a defendant. As of June 30, 2019, the Company has not recorded any liability on the consolidated balance sheet related to this matter. On October 12, 2018, the Delaware Court ordered that NuVasive begin advancing a portion of the legal fees for Mr. Miles' defense in the lawsuit, as well as Mr. Miles' legal fees incurred in pursuing advancement of his fees, pursuant to an indemnification agreement between NuVasive and Mr. Miles.

***Royalties***

The Company has entered into various intellectual property agreements requiring the payment of royalties based on the sale of products that utilize such intellectual property. These royalties primarily relate to products sold by Alphatec Spine and are based on fixed fees or calculated either as a percentage of net sales or on a per-unit sold basis. Royalties are included on the accompanying consolidated statements of operations as a component of cost of revenues. As of June 30, 2019, the Company is obligated to pay guaranteed minimum royalty payments under these agreements of approximately $5.7 million through 2023 and beyond.

**7. Orthotec Settlement**

On September 26, 2014, the Company entered into a Settlement and Release Agreement, dated as of August 13, 2014, by and among the Company and its direct subsidiaries, including Alphatec Spine, Inc., Alphatec Holdings International C.V., Scient'x S.A.S. and Surgiview S.A.S.; HealthpointCapital, LLC, HealthpointCapital Partners, L.P., HealthpointCapital Partners II, L.P., John H. Foster and Mortimer Berkowitz III; and Orthotec, LLC and Patrick Bertranou, (the "Settlement Agreement"). Pursuant to the Settlement Agreement, the Company agreed to pay Orthotec, LLC $49.0 million in cash, including initial cash payments totaling $1.75 million, which the Company previously paid in March 2014, and an additional lump sum payment of $15.75 million, which the Company previously paid in April 2014. The Company agreed to pay the remaining $31.5 million in 28 quarterly installments of $1.1 million and one additional quarterly installment of $0.7 million, commencing October 1, 2014. The payments set forth above are guaranteed by Stipulated Judgments held against the Company, HealthpointCapital Partners, L.P., HealthpointCapital Partners II, L.P., HealthpointCapital, LLC, John H. Foster and Mortimer Berkowitz III and, in the event of a default, will be entered and enforced against these entities and/or individuals in that order. In September 2014, the Company and HealthpointCapital entered into an agreement for joint payment of settlement whereby HealthpointCapital has agreed to contribute $5 million to the $49 million settlement amount. The $5 million is classified within stockholders' equity on the Company's condensed consolidated balance sheet due to the related party nature with HealthpointCapital and its affiliates. See Note 12 for further information.

As of June 30, 2019, the Company has made installment payments in the aggregate of $38.4 million, with a remaining outstanding balance of $19.4 million (including interest). The Company has the right to prepay the amounts due without penalty. In addition, the unpaid balance of the amounts due accrues interest at the rate of 7% per year until paid in full. The accrued but unpaid interest will be paid in quarterly installments of $1.1 million (or the full amount of the accrued but unpaid interest if less than $1.1 million) following the full payment of the $31.5 million in quarterly installments described above. No interest will accrue on the accrued interest. The Settlement Agreement provides for mutual releases of all claims in the Orthotec, LLC v. Surgiview, S.A.S, et al. matter in the Superior Court of California, Los Angeles County and all other related litigation matters involving the Company and its directors and affiliates.

**8. Acquisition of SafeOp Surgical, Inc.**

On March 9, 2018, the Company acquired SafeOp, a privately-held provider of neuromonitoring technology designed to enable effective intra-operative nerve health assessment. At the time of the acquisition, SafeOp had FDA 510(k) approval for a somatosensory evoked potential ("SSEP") monitoring technology. The Company has developed a product that will allow for both free run and triggered specific recording of muscle activity, also known as Electromyography ("EMG"). The Company received FDA clearance for SafeOp's EMG technology in February 2019 to complement the SSEP solution, and anticipates commercialization of the combined technology solution in mid-2019. In addition to expanding the Company's market presence in lateral spine surgery, the Company believes that the SafeOp solution will allow it to integrate neuromonitoring into its broader product portfolio and accelerate the transition to procedural integration of the entire portfolio.

Under the term of the definitive merger agreement, the Company paid $15.1 million in cash and issued 3,265,132 shares of common stock. The Company paid the full $15.1 million in cash consideration during the year ended December 31, 2018. On March 8, 2018, the Company issued 2,975,209 shares of common stock valued at $9.8 million, based on the closing share price of $3.30, and issued an additional 115,621 shares of common stock during the second quarter of 2018 and the remaining 174,302 during the third quarter of 2018.

In March 2018, the Company also issued $3 million in convertible notes that were convertible into a total of 987,578 shares of common stock, which included total interest incurred, and issued warrants to purchase 2.2 million shares of common stock at an exercise price of $3.50 per share. The convertible notes matured on March 9, 2019 and were settled in cash. Upon maturity, the Company recognized the value associated with the beneficial conversion feature calculated at issuance of $0.2 million within interest expense on the Company's condensed consolidated statement of operations for the six months ended June 30, 2019. Shares of common stock were issued upon achievement of post-closing milestones as described further below. The warrants remain outstanding as of June 30, 2019.

The first of the two milestones was achieved during the year ended December 31, 2018 and resulted in the issuance of 443,421 shares of common stock as payment. The second milestone pertaining to regulatory approval was achieved and the Company issued 886,843 shares of common stock as payment during the three months ended March 31, 2019. Prior to achievement, the contingent consideration was recorded as a liability and measured at fair value using a probability-weighted income approach, utilizing significant unobservable inputs including the probability of achieving each of the potential milestones and an estimated discount rate related to the risks of the expected cash flows attributable to the milestones. The fair value of the contingent consideration, and the associated liability relating to the contingent consideration at each reporting date, was re-assessed with the changes in fair value reflected in earnings. For the six months ended June 30, 2019, the fair value for the contingent consideration increased by $0.3 million due to the proximity of the achievement of the milestone. The amount was recorded within research and development expense on the condensed consolidated statement of operations and a corresponding increase in the liability on the Company's condensed consolidated balance sheet. The full liability was relieved upon achievement of the remaining milestone during the period.

### 9. Net Loss Per Share

Basic earnings per share ("EPS") is calculated by dividing the net income or loss available to common stockholders by the weighted average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted EPS is computed by dividing the net income available to common stockholders by the weighted average number of common shares outstanding for the period and the weighted average number of dilutive common stock equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, common stock subject to repurchase by the Company, convertible preferred stock, options, convertible notes and warrants are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

The following table presents the computation of basic and diluted net loss per share for continuing and discontinued operations (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| **Numerator:** | | | | |
| Loss from continuing operations | $ (12,406) | $ (7,064) | $ (25,322) | $ (8,918) |
| Loss from discontinued operations | (30) | (12) | (82) | (74) |
| Net loss | $ (12,436) | $ (7,076) | $ (25,404) | $ (8,992) |
| **Denominator:** | | | | |
| Weighted average common shares outstanding | 47,143 | 34,030 | 46,233 | 27,656 |
| Weighted average unvested common shares subject to repurchase | (263) | — | (276) | - |
| Weighted average common shares outstanding—basic and diluted | 46,880 | 34,030 | 45,957 | 27,656 |
| Net loss per share, basic and diluted: | | | | |
| Continuing operations | $ (0.26) | $ (0.21) | $ (0.55) | $ (0.32) |
| Discontinued operations | $ (0.00) | $ (0.00) | $ (0.00) | $ (0.00) |
| Net loss per share, basic and diluted | $ (0.27) | $ (0.21) | $ (0.55) | $ (0.32) |

The anti-dilutive securities not included in diluted net loss per share were as follows (in thousands):

| | As of June 30, 2019 | As of June 30, 2018 |
|---|---|---|
| Options to purchase common stock | 4,253 | 3,313 |
| Unvested restricted share awards | 6,641 | 2,139 |
| Series A Convertible Preferred Stock | 164 | 2,022 |
| Convertible Notes | — | 988 |
| Warrants to purchase common stock | 26,885 | 20,932 |
| Total | 37,943 | 29,394 |

**10. Stock Benefit Plans and Equity Transactions**

***Stock Benefit Plans***

On October 25, 2018, the Company's Board of Directors adopted an amendment to the Company's 2016 Equity Incentive Award Plan, which increased the maximum aggregate number of shares with respect to one or more stock rights that may be granted to any one person during any fiscal year from 500,000 to 1,250,000.

Total stock-based compensation for the three and six months ended June 30, 2019 and 2018 is as follows (in thousands):

| | Three Months Ended June 30, 2019 | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|---|---|
| Cost of revenues | $ 28 | $ 11 | $ 56 | $ 33 |
| Research and development | 293 | 129 | 533 | 13 |
| Sales, general and administrative | 2,030 | 1,008 | 3,374 | 1,721 |
| Total | $ 2,351 | $ 1,148 | $ 3,963 | $ 1,767 |

***Shares Reserved for Future Issuance***

As of June 30, 2019, the Company had reserved shares of its common stock for future issuance as follows (in thousands):

| | June 30, 2019 |
|---|---|
| Stock options outstanding | 4,253 |
| Unvested restricted stock award | 6,641 |
| Employee stock purchase plan | 132 |
| Series A convertible preferred stock | 164 |
| Warrants outstanding | 26,885 |
| Authorized for future grant under the Distributor and Development Services plans | 3,923 |
| Authorized for future grant under the Company equity plans | 2,014 |
| Total | 44,012 |

***Series A Convertible Preferred Stock***

In March 2017, the Company completed a private placement (the "2017 Private Placement") with certain institutional and accredited investors, including certain directors, executive officers and employees of the Company (collectively, the "Purchasers"), providing for the sale by the Company of 1,809,628 shares of the Company's common stock at a purchase price of $2.00 per share and 15,245 shares of newly designated Series A Convertible Preferred Stock at a purchase price of $1,000 per share (which shares were convertible into approximately 7,622,372 shares of common stock). Except as otherwise required by law, the holders of Series A Convertible Preferred Stock have no right to vote on matters submitted to a vote of the Company's stockholders.

During the six months ended June 30, 2019 and 2018, 3,715 and 1,274 shares of Series A Convertible Preferred Stock were converted into 1,857,586 and 636,997 shares of common stock. As of June 30, 2019, there were 328 shares of Series A Convertible Preferred Stock outstanding, which are convertible into 164,087 shares of common stock.

*2017 Warrants*

In connection with the 2017 Private Placement, the Company issued warrants to purchase up to 9,432,000 shares of the Company's common stock at an exercise price of $2.00 per share (the "2017 Common Stock Warrants"). The Company also issued warrants to purchase common stock to the exclusive placement agents for the issuance (the "2017 Banker Warrants"). The 2017 Banker Warrants were for the purchase of up to an aggregate of 471,600 shares of the Company's common stock with substantially the same terms as the 2017 Common Stock Warrants, except that they have an exercise price equal $2.50 per share. The 2017 Common Stock Warrants and the 2017 Banker Warrants (collectively, the "2017 Warrants") expire on June 15, 2022. The 2017 Warrants may not be exercised by the holder to the extent that the holder, together with its affiliates, would beneficially own, after such exercise more than 4.99% of the shares of the Company's common stock then outstanding (subject to the right of the holder to increase or decrease such beneficial ownership limitation upon notice to us, provided that such limitation cannot exceed 9.99%) and provided that any increase in the beneficial ownership limitation shall not be effective until 61 days after such notice is delivered.

In conjunction with the 2018 Private Placement described further below, during the six months ended June 30, 2018, a holder of 2.4 million 2017 Warrants exercised all their 2017 Warrants at the original exercise price of $2.00 per warrant in exchange for the issuance of additional warrants. As a result of the warrant exercise, the Company received gross proceeds of $4.8 million during the six months ended June 30, 2018.

During the six months ended June 30, 2018, excluding the $4.8 million described above, the Company received proceeds of approximately $0.9 million in connection with the exercise of approximately 0.4 million of 2017 Common Stock Warrants. There were 0.1 million 2017 Warrant exercises during the three and six months ended June 30, 2019 for total cash proceeds of $0.2 million. As of June 30, 2019, there were 3,657,000 2017 Common Stock Warrants outstanding.

During the six months ended June 30, 2018, 304,182 of the 2017 Banker Warrants were exercised for total cash proceeds upon exercise of $0.8 million during the period. There were 18,864 2017 Banker Warrant exercises for the six months ended June 30, 2019 for total cash proceeds of less than $0.1 million. A total of 148,554 2017 Banker Warrants remained outstanding as of June 30, 2019.

All the 2017 Warrants were deemed to qualify for equity classification under authoritative accounting guidance.

*Series B Convertible Preferred Stock*

On March 8, 2018, the Company completed the 2018 Private Placement to certain institutional and accredited investors, including certain directors and executive officers of the Company, providing for the sale by the Company at a purchase price of $1,000 per share, 45,200 of newly designated Series B Convertible Preferred Stock, which shares of preferred stock were automatically converted into 14,349,236 shares of the Company's common stock upon approval by the Company's stockholders at the 2018 annual meeting of stockholders held in May 2018, and warrants to purchase up to 12,196,851 shares of common stock at an exercise price of $3.50 per share (the "2018 Common Stock Warrants"). The 2018 Common Stock Warrants became exercisable following stockholder approval at the 2018 annual meeting of stockholders, are subject to certain ownership limitations in certain cases, and expire five years after the date of such stockholder approval. The gross proceeds from the 2018 Private Placement were approximately $45.2 million.

Pursuant to the terms of the purchase agreement entered into in connection with the 2018 Private Placement, from the date of the stockholder approval of the 2018 Private Placement, or May 17, 2018, through the first anniversary of the effective date of the resale registration statement related to the 2018 Private Placement, or May 11, 2019, if the Company had issued any shares of common stock or common stock equivalents, subject to certain permitted exceptions, at a price below the conversion price on the date stockholder approval was obtained (a "Dilutive Issuance"), the Company was required to issue an additional number of shares of common stock to the purchasers in the 2018 Private Placement in amount equal the number of shares of common stock such purchasers would have received if the Dilutive Issuance occurred prior to the date the Company's stockholders approved the 2018 Private Placement. No such Dilutive Issuances occurred prior to the expiration.

***2018 Warrants***

The 2018 Common Stock Warrants (the "2018 Warrants") have a five year life and are exercisable for cash or by cashless exercise. Some of the 2018 Warrants may not be exercised by the holder to the extent that the holder, together with its affiliates, would beneficially own, after such exercise more than 4.99% of the shares of the Company's common stock then outstanding (subject to the right of the holder to increase or decrease such beneficial ownership limitation upon notice to us, provided that such limitation cannot exceed 9.99%) and provided that any increase in the beneficial ownership limitation shall not be effective until 61 days after such notice is delivered.

In addition to the 12,196,851 warrants issued in the 2018 Private Placement, the Company issued 1,800,000 warrants to an existing holder with identical terms to the 2018 Warrants, including the exercise price of $3.50.

During the six months ended June 30, 2019, 0.1 million of the 2018 Warrants were exercised for total proceeds of $0.5 million. No 2018 Warrants were exercised for the six months ended June 30, 2018.

All the 2018 Warrants were deemed to qualify for equity classification under authoritative accounting guidance.

***Squadron Warrants***

As further described in Note 5, during the year ended December 31, 2018, in connection with the initial debt financing with Squadron, the Company issued warrants to purchase 845,000 shares of common stock at an exercise price of $3.15 per share. An additional 4,838,710 warrants were issued at an exercise price of $2.17 per share during the second quarter of 2019, in conjunction with the Company's draw on the expanded credit facility. The warrants have a seven-year term and are immediately exercisable. In accordance with authoritative accounting guidance, the warrants classified for equity treatment upon issuance and the portion allocated to the outstanding debt were recorded as a debt discount to the face of the debt liability based on fair value to be amortized into interest expense over the life of the debt agreement. As the warrants provide for partial price protection that allow for a reduction in the price in the event of a lower per share priced issuance, the warrants were valued utilizing a Monte Carlo simulation that considers the probabilities of future financings. The Monte Carlo model simulates the present value of the potential outcomes of future stock prices of the Company over the seven-year life of the warrants. The projection of stock prices is based on the risk-free rate of return and the volatility of the stock price of the Company and correlates future equity raises based on the probabilities provided.

A summary of all outstanding warrants is as follows:

| | Number of Warrants | Strike Price |
|---|---|---|
| 2017 Common Stock Warrants | 3,657,000 | $ 2.00 |
| 2017 Banker Warrants | 148,554 | $ 2.50 |
| 2018 Common Stock Warrants | 13,860,851 | $ 3.50 |
| Merger Warrants | 2,200,000 | $ 3.50 |
| Executive | 1,327,434 | $ 5.00 |
| Squadron Capital | 845,000 | $ 3.15 |
| Squadron Capital | 4,838,710 | $ 2.17 |
| Other | 7,812 | $ 19.20 |
| Total | 26,885,361 | |

***2017 Distributor Inducement Plan***

In December 2017, the Board of Directors approved and adopted the 2017 Distributor Inducement Plan which authorizes the Company to issue to distributors restricted shares of common stock of the Company and/or warrants to purchase the Company's common stock. The warrants are issuable with an exercise price equal to the fair market value of the common stock on the date of issuance. Each warrant and common stock issuance is subject to a time-based or net sales-based vesting provision. The Board of Directors authorized the grant of up to 1.0 million shares of common stock under the 2017 Distributor Inducement Plan. As of June 30, 2019, 0.3 million warrants and 17,000 shares of common stock were earned under the 2017 Distributor Inducement Plan. Total expense for the plan was $0.1 million for both the three months ended June 30, 2019 and 2018 and $0.2 million and $0.1 million for the six months ended June 30, 2019 and 2018, respectively.

In December 2017, the Board of Directors also authorized the grant of warrants to purchase 50,000 shares of common stock, and 75,000 restricted stock units to a distributor of which 60,000 were earned and issued. These warrants and restricted stock units are subject to time based and net sales based vesting conditions.

***2017 Development Services Plan***

In December 2017, the Board approved and adopted the 2017 Development Services Plan which authorizes the Company to enter into Development Services Agreements with third-party individuals or entities whereby, upon the achievement of certain Company financial and commercial revenue milestones, future royalty payments for product and/or intellectual property development work may be paid in either cash or restricted shares of Company common stock at the option of the developer. Each common stock issuance would be subject to net sales-based vesting provisions and satisfaction of applicable laws and market regulations regarding the issuance of restricted shares to such developers. The Board of Directors authorized the grant of up to 3,000,000 shares of common stock under the Development Services Plan. As of June 30, 2019, 2.3 million shares of common stock have been designated under the 2017 Development Services Plan, but no common stock elections, grants or cash payouts have been made as of June 30, 2019.

**11. Income Taxes**

To calculate its interim tax provision, at the end of each interim period the Company estimates the annual effective tax rate and applies that to its ordinary quarterly earnings. In addition, the effect of changes in enacted tax laws or rates or tax status is recognized in the interim period in which the change occurs. The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment including, but not limited to, the expected operating income for the year, projections of the proportion of income earned and taxed in foreign jurisdictions, permanent and temporary differences between book and tax amounts, and the likelihood of recovering deferred tax assets generated in the current year. The accounting estimates used to compute the provision for income taxes may change as new events occur, additional information is obtained or the tax environment changes.

Intraperiod tax allocation rules require the Company to allocate the provision for income taxes between continuing operations and other categories of earnings, such as discontinued operations. In periods in which the Company has a year-to-date pre-tax loss from continuing operations and pre-tax income in other categories of earnings, such as discontinued operations, the Company must allocate the tax provision to the other categories of earnings, and then record a related tax benefit in continuing operations.

The unrecognized tax benefits at June 30, 2019 and December 31, 2018 were $4.4 million for both periods, with no changes occurring during the year-to-date period. With the facts and circumstances currently available to the Company, it is reasonably possible that the amount of reserves that could reverse over the next 12 months is approximately $0.1 million. The Company recognizes interest and penalties related to uncertain tax positions as a component of the income tax provision. The Company is not currently under examination by the Internal Revenue Service, foreign, or state or local tax authorities.

The income tax benefit from continuing operations for the three and six months ended June 30, 2018 consists primarily of a release of the valuation allowance due to an increase in net deferred tax liabilities recorded as a result of the acquisition of SafeOp. The Company’s effective tax rate of (0.23)% for the six months ended June 30, 2019 differs from the federal statutory rate of 21% primarily due to the Company being in a net loss position.

**12. Related Party Transactions**

In July 2016, the Company entered into a forbearance agreement with HealthpointCapital, LLC, HealthpointCapital Partners, L.P., and HealthpointCapital Partners II, L.P. (collectively, "HealthpointCapital"), pursuant to which HealthpointCapital, on behalf of the Company, paid $1.0 million of the $1.1 million payment due and payable by the Company to Orthotec on July 1, 2016 and agreed to not exercise its contractual rights to seek an immediate repayment of such amount. Pursuant to this forbearance agreement, the Company repaid this amount in September 2016. The Company and HealthpointCapital also entered into an agreement for joint payment of settlement whereby HealthpointCapital has agreed to contribute $5 million to the $49 million Orthotec settlement amount.

During the second quarter of 2018, HealthpointCapital Partners, L.P., and HealthpointCapital Partners II, L.P. distributed its holdings in the Company's common stock to its limited partners. As a result, the fund is no longer a shareholder of the Company as of June 30, 2019. The $5 million receivable from HealthpointCapital, LLC continues to be classified within stockholders' equity on the Company's condensed consolidated balance sheet due to the related party nature with HealthpointCapital affiliates.

Certain of the Company's board of directors and senior management participated in the March 2017 and 2018 Private Placements.

**13. Restructuring**

In connection with the sale of the International Business (described in Note 4), the Company terminated employment agreements with several executive officers, including the chief executive officer and the chief financial officer, and commenced an employee headcount reduction program. In conjunction with the restructuring program, the Company recorded restructuring expenses related to severance liabilities and post-employment benefits. A rollforward of the accrued restructuring liability is presented below (in thousands):

| | | |
|---|---|---|
| Balance at January 1, 2019 | $ | 710 |
| Accrued restructuring charges | | 60 |
| Payments | | (608) |
| Balance at March 31, 2019 | | 162 |
| Accrued restructuring charges | | — |
| Payments | | (22) |
| Balance at June 30, 2019 | $ | 140 |

All activities and costs are expected to be completed during 2019.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following management's discussion and analysis of our financial condition and results of operations in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto that appear elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC"), on March 29, 2019. In addition to historical information the following management's discussion and analysis of our financial condition and results of operations includes forward-looking information that involves risks, uncertainties, and assumptions. Our actual results and the timing of events could differ materially from those anticipated by these forward-looking statements as a result of many factors, such as those set forth under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2018 and any updates to those risk factors filed from time to time in our subsequent periodic and current reports filed with the SEC.*

**Overview**

We are a medical technology company focused on the design, development, and advancement of technology for better surgical treatment of spinal disorders. We are dedicated to revolutionizing the approach to spine surgery. We have a broad product portfolio designed to address the majority of the U.S. market for fusion-based spinal disorder solutions. We intend to drive growth by exploiting our collective spine experience and investing in the research and development to continually differentiate our solutions and improve spine surgery. We believe our future success will be fueled by introducing market-shifting innovation to the spine market, and we believe that we are well-positioned to capitalize on current spine market dynamics.

We market and sell our products in the U.S. through a network of independent distributors and direct sales representatives. An objective of our leadership team is to deliver increasingly consistent, predictable growth. To accomplish this, we have partnered more closely with new and existing distributors to create a more dedicated and loyal sales channel for the future. We have added, and intend to continue to add, new high-quality dedicated distributors to expand future growth. We believe this will allow us to reach an untapped market of surgeons, hospitals, and national accounts across the U.S., as well as better penetrate existing accounts and territories.

We have made significant progress in the transition of our sales channel since early 2017, driving the percent of sales contributed by our strategic distribution channel from approximately 80% and 76% for the three and six months ended June 30, 2018, respectively, to 88% and 86% for the three and six months ended June 30, 2019, respectively. Going forward, we intend to continue to relentlessly drive toward a fully exclusive network of independent and direct sales agents. Recent consolidation in the industry is facilitating the process, as large, seasoned agents are seeking opportunities to re-enter the spine market by partnering with spine-focused companies that have broad, growing product portfolios.

**Sale of International Business**

On September 1, 2016, we completed the sale of our international distribution operations and agreements, including our wholly-owned subsidiaries in Japan, Brazil, Australia, China and Singapore and substantially all of the assets of our other sales operations in the United Kingdom and Italy ("International Business"), to an affiliate of Globus ("Globus Transaction"). Following the closing of the Globus Transaction, we now operate in the U.S. market only and are restricted from marketing and selling our products in foreign markets pursuant to the terms and conditions, and for the time periods, set forth in the definitive documents related to the Globus Transaction.

**Revenue and Expense Components**

The following is a description of the primary components of our revenues and expenses:

*Revenues*. We derive our revenues primarily from the sale of spinal surgery implants used in the treatment of spine disorders. Spinal implant products include pedicle screws and complementary implants, interbody devices, plates, and tissue-based materials. Our revenues are generated by our direct sales force and independent distributors. Our products are requested directly by surgeons and shipped and billed to hospitals and surgical centers. Currently, most of our business is conducted with customers within markets in which we have experience and with payment terms that are customary to our business. We may defer revenues until the time of collection if circumstances related to payment terms, regional market risk or customer history indicate that collectability is not certain.

*Cost of revenues*. Cost of revenues consists of direct product costs, royalties, milestones and the amortization of purchased intangibles. Our product costs consist primarily of direct labor, overhead, and raw materials and components. The product costs of certain of our biologics products include the cost of procuring and processing human tissue. We incur royalties related to the technologies that we license from others and the products that are developed in part by surgeons with whom we collaborate in the product development process. Amortization of purchased intangibles consists of amortization of developed product technology.

*Research and development*. Research and development expense consists of costs associated with the design, development, testing, and enhancement of our products. Research and development expense also includes salaries and related employee benefits, research-related overhead expenses, fees paid to external service providers in both cash and equity, and costs associated with our Scientific Advisory Board and Executive Surgeon Panels.

*Sales, general and administrative*. Sales, general and administrative expense consists primarily of salaries and related employee benefits, sales commissions and support costs, depreciation of our surgical instruments, regulatory affairs, quality assurance costs, professional service fees, travel, medical education, trade show and marketing costs, insurance and legal expenses.

*Litigation-related expenses.* Litigation-related expenses are costs incurred for our ongoing litigation, primarily with NuVasive, Inc.

*Transaction related expenses.* Reflects the recognition of transaction expenses incurred as part of the SafeOp acquisition.

*Gain on settlement.* Gain on settlement consists of a gain of approximately $6.2 million for the year ended December 31, 2018 as a result of the settlement agreement with Elite Medical Holdings and Pac 3 Surgical, pursuant to which we made a cash payment of $0.4 million as the final and total compensation under the collaboration and related amendment. The gain reflects the reversal of accrued obligations previously recorded under the collaboration.

*Restructuring expenses*. Restructuring expense consists of severance, social plan benefits and related taxes in connection with our ongoing cost rationalization efforts, including the termination of our manufacturing operations in California in 2017.

*Total other income (expense)*. Total other income (expense) includes interest income, interest expense, gains and losses from foreign currency exchanges and other non-operating gains and losses.

*Income tax benefit.* Income tax benefit from continuing operations primarily consists of release of the valuation allowance from the SafeOp acquisition, partially offset by state taxes.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. On an on-going basis, we evaluate our estimates and assumptions, including those related to revenue recognition, allowances for accounts receivable, inventories and intangible assets, stock-based compensation and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumption conditions.

Critical accounting policies are those that, in management's view, are most important in the portrayal of our financial condition and results of operations. Aside from newly implemented accounting policies related to revenues discussed below and for the changes disclosed in Note 2 to the Notes to Condensed Consolidated Financial Statements included in Item 1, Part I of this Quarterly Report on Form 10-Q, management believes there have been no material changes during the three and six months ended June 30, 2019 to the critical accounting policies discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended December 31, 2018 filed with the SEC on March 29, 2019.

***Leases***

Effective January 1, 2019, we adopted ASC No. 2016-02, Leases (Topic 842) ("ASU 2016-02" or "ASC 842"), which supersedes the current accounting for leases, using the modified retrospective transition method. The Company has elected to apply the practical expedients allowed by the standard for existing leases. The new standard, while retaining two distinct types of leases, finance and operating, (i) requires lessees to record a right-of-use asset and a related liability for the rights and obligations associated with a lease, regardless of lease classification, and recognize lease expense in a manner similar to current accounting, (ii) eliminates current real estate specific lease provisions, (iii) modifies the lease classification criteria and (iv) aligns many of the underlying lessor model principles with those in the new revenue standard. We determined the initial classification and measurement of its right-of-use assets and lease liabilities at the lease commencement date, or the adoption date, if later, and thereafter if modified. We recognized a right-of-use asset for our operating leases with lease terms greater than 12 months. The lease term includes any renewal options and termination options that we are reasonably assured to exercise. The present value of lease payments is determined by using the incremental borrowing rate for operating leases determined by using the incremental borrowing rate of interest that we would pay to borrow on a collateralized basis an amount equal to the lease payments in a similar economic environment. We applied the new guidance to our existing facility lease at the time of adoption and recognized a right-of-use asset of $2.4 million and operating lease liability of $2.9 million, during the first period of adoption, and recorded a reversal of the previous deferred rent balance under the previous lease guidance of approximately $0.6 million.

Rent expense for operating leases is recognized on a straight-line basis over the reasonably assured lease term based on the total lease payments and is included in research and development and general and administrative expenses in the statements of operations and comprehensive loss.

**Results of Operations**

The tables below set forth certain statements of operations data for the periods indicated (in thousands). Our historical results are not necessarily indicative of the operating results that may be expected in the future.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Revenues: | | | | |
| Revenue from U.S. products | $ 26,093 | $ 20,409 | $ 49,048 | $ 39,610 |
| Revenue from international supply agreement | 1,226 | 1,633 | 2,826 | 3,739 |
| Total revenues | 27,319 | 22,042 | 51,874 | 43,349 |
| Cost of revenues | 8,433 | 6,488 | 16,420 | 12,890 |
| Gross profit | 18,886 | 15,554 | 35,454 | 30,459 |
| Operating expenses: | | | | |
| Research and development | 3,360 | 2,009 | 6,829 | 3,795 |
| Sales, general and administrative | 24,568 | 17,538 | 45,568 | 34,795 |
| Litigation-related expenses | 1,200 | 2,234 | 3,823 | 2,814 |
| Amortization of intangible assets | 172 | 187 | 354 | 364 |
| Transaction-related expenses | — | (62) | — | 1,480 |
| Gain on settlement | — | - | — | (6,168) |
| Restructuring expenses | — | 193 | 60 | 591 |
| Total operating expenses | 29,300 | 22,099 | 56,634 | 37,671 |
| Operating loss | (10,414) | (6,545) | (21,180) | (7,212) |
| Total other expense, net | (1,921) | (1,784) | (4,040) | (3,429) |
| Loss from continuing operations before taxes | (12,335) | (8,329) | (25,220) | (10,641) |
| Income tax (benefit) provision | 71 | (1,265) | 102 | (1,723) |
| Loss from continuing operations | (12,406) | (7,064) | (25,322) | (8,918) |
| Loss from discontinued operations, net of applicable taxes | (30) | (12) | (82) | (74) |
| Net loss | $ (12,436) | $ (7,076) | $ (25,404) | $ (8,992) |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Revenues by source | | | | |
| Revenue from U.S. products | $ 26,093 | $ 20,409 | $ 49,048 | $ 39,610 |
| Revenue from international supply agreement | 1,226 | 1,633 | 2,826 | 3,739 |
| Total revenues | $ 27,319 | $ 22,042 | $ 51,874 | $ 43,349 |
| | | | | |
| Gross profit by source | | | | |
| Revenue from U.S. products | $ 18,841 | $ 15,462 | $ 35,235 | $ 30,229 |
| Revenue from international supply agreement | 45 | 92 | 219 | 230 |
| Total gross profit | $ 18,886 | $ 15,554 | $ 35,454 | $ 30,459 |
| | | | | |
| Gross profit margin by source | | | | |
| Revenue from U.S. products | 72.2% | 75.8% | 71.8% | 76.3% |
| Revenue from international supply agreement | 3.7% | 5.6% | 7.7% | 6.2% |
| Total gross profit margin | 69.1% | 70.6% | 68.3% | 70.3% |

***Three and Six Months Ended June 30, 2019 Compared to the Three and Six Months Ended June 30, 2018***

*Total revenues*. Total revenues were $27.3 million for the three months ended June 30, 2019 compared to $22.0 million for the three months ended June 30, 2018, representing an increase of $5.3 million, or 24.1%. Total revenues were $51.9 million for the six months ended June 30, 2019 compared to $43.3 million for the six months ended June 30, 2018, representing an increase of $8.6 million, or 19.9%.

Revenue from U.S. products were $26.1 million for the three months ended June 30, 2019 compared to $20.4 million for the three months ended June 30, 2018, representing an increase of $5.7 million, or 27.9% and were $49.0 million for the six months ended June 30, 2019 and $39.6 million for the six months ended June 30, 2018, representing an increase of $9.4 million, or 23.7%. The increases in revenue for the three and six months ended June 30, 2019 was attributed to the launch of various newly developed products and to our focus on our strategic distribution channel, as detailed below (in thousands):

| | Three Months Ended June 30, | | | | Increase (Decrease) | | Six Months Ended June 30, | | | | Increase (Decrease) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | | 2018 | | $ | % | 2019 | | 2018 | | $ | % |
| U.S. revenues by distributor type: | | | | | | | | | | | | |
| Strategic distribution | $22,854 | 88% | $16,248 | 80% | $6,606 | 41% | $42,226 | 86% | $30,121 | 76% | $12,105 | 40% |
| Legacy and terminated distribution | 3,239 | 12% | 4,161 | 20% | (922) | (22)% | 6,822 | 14% | 9,489 | 24% | (2,667) | (28)% |
| Total U.S. revenues | $26,093 | 100% | $20,409 | 100% | $5,684 | 28% | $49,048 | 100% | $39,610 | 100% | $ 9,438 | 24% |

Revenue from international supply agreement which is attributed to sales to Globus under which we supply to Globus certain of its implants and instruments at agreed-upon prices for a minimum term of three years, was $1.2 million for the three months ended June 30, 2019 compared to $1.6 million for the three months ended June 30, 2018, representing a decrease of $0.4 million and $2.8 million for the six months ended June 30, 2019 compared to $3.7 million for the six months ended June 30, 2018, representing a decrease of $0.9 million. We expect these revenues to continue to decrease over the next several quarters, as Globus continues to register its own products in international markets. Globus has the option to extend the term for up to two additional twelve month periods subject to Globus meeting specified purchase requirements. During the first quarter of 2019, Globus notified us that it will exercise the option to extend the agreement an additional twelve months through August 2020.

*Cost of revenues*. Cost of revenues was $8.4 million for the three months ended June 30, 2019 compared to $6.5 million for the three months ended June 30, 2018, representing an increase of $1.9 million, or 29.2% and $16.4 million for the six months ended June 30, 2019 compared to $12.9 million for the six months ended June 30, 2018, representing an increase of $3.5 million or 27.1%.

Cost of revenue from U.S. products for the three months ended June 30, 2019 was $7.3 million compared to $4.9 million for the three months ended June 30, 2018, representing an increase of $2.4 million, or 49.0% and $13.8 million for the six months ended June 30, 2019 compared to $9.4 million for the six months ended June 30, 2018, representing an increase of $4.4 million, or 46.8%. The increases are primarily consistent with our revenue growth as well as increases in non-cash excess and obsolescence expense of approximately $4.1 million for the six months ended as June 30, 2019 as we are launching newly developed products and phasing out older, legacy products.

Cost of revenues from international supply agreement were $1.2 million for the three months ended June 30, 2019 compared to $1.5 million for the three months ended June 30, 2018 and $2.6 million for the six months ended June 30, 2019 compared to $3.5 million for the six months ended June 30, 2018. These decreases were attributed to a reduction in sales volumes and related costs under the supply agreement with Globus.

*Gross profit*. Gross profit was $18.9 million for the three months ended June 30, 2019 compared to $15.6 million for the three months ended June 30, 2018, representing an increase of $3.3 million, or 21.2% and $35.5 million for the six months ended June 30, 2019 compared to $30.5 million for the six months ended June 30, 2018, representing a decrease of $5.0 million, or 16.4%.

Gross profit margin from U.S. product revenue was 72.2% for the three months ended June 30, 2019 compared to 75.8% for the three months ended June 30, 2018 and 71.8% for the six months ended June 30, 2019 compared to 76.3% for the six months ended June 30, 2018. The decreases were attributable to increases in excess and obsolescence expense as we are launching newly developed products and phasing out older products.

Gross profit margin from international supply agreement was 3.7% for the three months ended June 30, 2019 compared to 5.6% for the three months ended June 30, 2018 and 7.7% for the six months ended June 30, 2019 compared to 6.2% for the six months ended June 30, 2018. The changes in gross margin from international supply agreement was primarily related to the impact of fixed minimum royalty costs, product mix, and to a lesser extent, decrease in average selling price for certain products.

*Research and development expense*. Research and development expense increased $1.4 million, or 70.0% during the three months ended June 30, 2019 compared to the three months ended June 30, 2018 and increased $3.0 million, or 78.9% during the six months ended June 30, 2019 compared to the six months ended June 30, 2018. These increases were primarily related to the integration of the SafeOp technology into our product portfolio, as evidenced by the achievement of the second SafeOp contingent consideration milestone, an increase of personnel related costs as well as increased product development costs and related research expenses. We expect research and development expenses to increase in future periods as we hire additional engineering and development talent, and continue to invest in our product pipeline.

*Sales, general and administrative expense.* Sales, general and administrative expense increased $7.1 million, or 40.6% during the three months ended June 30, 2019 compared to the three months ended June 30, 2018 and increased $10.8 million, or 31.0% during the six months ended June 30, 2019 compared to the six months ended June 30, 2018. The increases were primarily related to increased commission and related sales compensation expenses associated with our increase in U.S. revenue and continued investment in building out our strategic distribution channel, as well as increased marketing efforts, including additional headcount. Additionally, our stock-based compensation increased during the three and six months ended 2019. We expect our sales, general and administrative expenses to increase in absolute dollars in line with expected increase in our U.S. product revenue.

*Litigation-related expenses.* Litigation-related expenses of $1.2 million for the three months ended June 30, 2019 and $2.2 million for the three months ended June 30, 2018 and $3.8 million for the six months ended June 30, 2019 and $2.8 million for the six months ended June 30, 2018 are costs incurred for our ongoing litigation, primarily with NuVasive, Inc.

*Amortization of acquired intangible assets.* Amortization of acquired intangible assets remained consistent for the three and six months ended June 30, 2019 compared to the three and six months ended June 30, 2018. This expense represents amortization in the period for intangible assets associated with general business assets, intellectual property, licenses and other assets obtained in acquisitions and licensing agreements.

*Transaction-related expenses.* Transaction-related expenses of $1.5 million for the six months ended June 30, 2018 are attributed to advisory and legal fees and other transaction costs incurred in connection with the SafeOp acquisition.

*Gain on settlement.* In February 2018, we reached a settlement agreement with Elite Medical Holdings and Pac 3 Surgical, pursuant to which we made a cash payment of $0.4 million as the final and total compensation under a collaboration agreement and related amendment between the Company and these third parties. In addition, the parties agreed to release each other and waive any and all rights and claims arising from the collaboration agreement and amendment. We recorded a gain of approximately $6.2 million for the six months ended June 30, 2018, reflecting the reversal of accrued obligations previously recorded under the collaboration agreement.

*Restructuring expense*. Restructuring expense was $0.0 million for the three months ended June 30, 2019 compared to $0.2 million for the three months ended June 30, 2018 and $0.1 million for the six months ended June 30, 2019 compared to $0.6 million for the six months ended June 30, 2018. Beginning in late 2016 with the sale of our international business to Globus and continuing in 2018, we began a corporate initiative to rationalize our cost structure in line with our reduced operations and implemented a strategic repositioning of the Company, including the changeover of our senior leadership team, and have incurred related restructuring costs consisting primarily of severance and other personnel charges.

*Total other income (expense), net.* Total other income (expense), net, increased $0.1 million during the three months ended June 30, 2019 compared to the three months ended June 30, 2018 and increased $0.6 million during the six months ended June 30, 2019 compared to the six months ended June 30, 2018 primarily due to our new debt arrangements.

*Income tax provision (benefit)*. The 2018 income tax benefit from continuing operations primarily consists of the release of the valuation allowance related to the SafeOp acquisition, partially offset by state taxes. ASC 740-20 requires total income tax expense or benefit to be allocated among continuing operations, discontinued operations, extraordinary items, other comprehensive income and items charged directly to shareholders' equity. This allocation is referred to as intra-period tax allocation. Accordingly, we are required to allocate the provision or benefit for income taxes between continuing operations and discontinued operations.

**Liquidity and Capital Resources**

We have incurred significant net losses since inception and relied on our ability to fund our operations through revenues from the sale of our products, debt financings and equity financings. As we have incurred losses, a successful transition to profitability is dependent upon achieving a level of revenues adequate to support our cost structure. This may not occur and, unless and until it does, we will continue to need to raise additional capital. At June 30, 2019, our principal sources of liquidity consisted of cash of $18.6 million and accounts receivable (net) of $13.6 million. We believe that our current available cash, combined with the availability of our expanded credit facility with Squadron Capital (described below) and draws on our revolving credit facility, will be sufficient to fund our planned expenditures and meet our obligations for at least 12 months following our financial statement issuance date.

Historically, our principal sources of cash have included customer payments from the sale of our products, proceeds from the issuance of common and preferred stock and proceeds from the issuance of debt. Our principal uses of cash have included cash used in operations, payments relating to purchases of surgical instruments, repayments of borrowings under the Amended Credit Facility, payments due under the Orthotec settlement agreement and acquisitions of businesses and intellectual property rights. We expect that our principal uses of cash in the future will be similar. We expect that, as our revenues grow, our sales and marketing, research and development expenses and our capital expenditures will continue to grow and, as a result, we will need to generate significant net revenues to achieve profitability. We expect operating losses and negative cash flows to continue for at least the next year as we continue to incur costs related to the execution of our operating plan and introduction of new products.

On March 27, 2019, we closed on an expanded credit facility with Squadron for up to $30 million in additional secured financing. This additional financing is provided under our existing credit facility with Squadron. In June 2019, we took a draw of $10 million on the expanded credit facility to be used for general corporate purposes. The additional borrowings under the credit facility will mature concurrent with the current secured financing from Squadron and bear interest at LIBOR plus 8% per annum, subject to a 10% floor and a 13% ceiling. Interest-only payments are due monthly through May 2021, followed by principal payable in 29 equal monthly installments beginning June 2021 and a lump-sum payment payable at maturity in November 2023. In conjunction with the first draw under the expanded credit facility, we issued to Squadron warrants to purchase 4,838,710 shares of our common stock at an exercise price of $2.17 per share. The warrants have a seven-year term and are immediately exercisable. No additional warrants are due upon future draws.

We may seek additional funds from public and private equity or debt financings, borrowings under new or existing debt facilities or other sources to fund our projected operating requirements. However, there is no guarantee that we will be able to obtain further financing, or do so on reasonable terms. If we are unable to raise additional funds on a timely basis, or at all, we would be materially adversely affected. As more fully described below, our debt agreements include traditional lending and reporting covenants, including a financial covenant that requires us to maintain a minimum fixed charge coverage ratio beginning in April 2020 and a minimum liquidity covenant of $5.0 million effective through March 2020. Should at any time we fail to maintain compliance with these covenants, we will need to seek waivers or amendments to the debt agreements. If we are unable to secure such waivers or amendments, we may be required to classify our obligations under the debt agreements in current liabilities on our consolidated balance sheet. We may also be required to repay all or a portion of outstanding indebtedness under the debt agreements, which would require us to obtain further financing. We were in compliance with the covenants under the credit agreement at June 30, 2019.

A substantial portion of our available cash funds is held in business accounts with reputable financial institutions. At times, however, our deposits may exceed federally insured limits and thus we may face losses in the event of insolvency of any of the financial institutions where our funds are deposited. We did not hold any marketable securities as of June 30, 2019.

*Amended Credit Facility, Squadron Credit Agreement and Other Debt*

Our Amended Credit Facility with MidCap provides for a revolving credit commitment up to $22.5 million. As of June 30, 2019, $10.7 million was outstanding under the revolving line of credit.

The revolving line of credit accrues interest at LIBOR plus 6.0%, reset monthly. At June 30, 2019, the revolving line of credit carried an interest rate of 8.44%. The borrowing base is determined based on the value of domestic eligible accounts receivable. As collateral for the Amended Credit Facility, MidCap has a first lien security interest in accounts receivable and a second lien on substantially all other assets. The Amended Credit Facility also includes several event of default provisions, such as payment default, insolvency conditions and a material adverse effect clause, which could cause interest to be charged at a rate which is up to five percentage points above the rate effective immediately before the event of default or result in MidCap's right to declare all outstanding obligations immediately due and payable.

On September 1, 2016, we entered into the Globus facility, pursuant to which Globus agreed to loan us up to $30 million. We made an initial draw of $25 million under the Globus facility with an additional draw of $5 million made in the fourth quarter of 2016. In November 2018, the $29.2 million outstanding was paid in full.

On November 6, 2018, we closed the $35 million Term Loan with Squadron for net proceeds of approximately $34.1 million, which were partially used to retire our existing $29.2 million term debt with Globus noted above. In addition, in June 2019, we took a draw of $10 million from our total available $30 million expanded credit facility with Squadron. The total debt outstanding with Squadron has a five-year maturity and bears interest at LIBOR plus 8% (10.5% as of June 30, 2019) per annum. The credit agreement specifies a minimum interest rate of 10% and a maximum of 13% per year. Interest-only payments are due monthly through May 2021, followed by $10 million in principal payable in 29 equal monthly installments beginning June 2021 and a $25 million lump-sum payment payable at maturity in November 2023. As collateral for the Term Loan, Squadron has a first lien security interest in substantially all assets except for accounts receivable.

We entered into an Inventory Financing Agreement whereby we may draw up to $3.0 million for the purchase of inventory to accrue interest at a rate of LIBOR plus 8% and also includes a 10% floor and 13% ceiling. All principal will become due and payable upon maturity on November 6, 2023 and all interest will be paid monthly. Should we elect to prepay the Squadron credit agreement, all amounts due under the Inventory Financing Agreement will become mandatorily due.

Our various debt agreements include several event of default provisions, such as payment default, insolvency conditions and a material adverse effect clause, which could cause interest to be charged at a rate which is up to five percentage points above the rate effective immediately before the event of default or result in our lenders' rights to declare all outstanding obligations immediately due and payable. Furthermore, the credit agreements contain various covenants, including various negative covenants including a $5 million minimum liquidity requirement through March 31, 2020. The minimum liquidity covenant will be replaced by a fixed charge ratio, pursuant to which operating cash to fixed charges (as defined) must equal at least 1:1 on a rolling 12-month basis, beginning April 2020. We were in compliance with the covenants under the credit agreements at June 30, 2019.

As of June 30, 2019, we have made $38.4 million in Orthotec settlement payments and there remains an aggregate $19.4 million of Orthotec settlement payments (including interest) to be paid by us.

*Operating Activities*

We used net cash of $14.6 million from operating activities for the six months ended June 30, 2019. During this period, net cash used in operating activities consisted of our net loss adjusted for non-cash adjustments including amortization, depreciation, stock-based compensation, provision for doubtful accounts, provision for excess and obsolete inventory, interest expense related to amortization of debt discount and issuance costs, beneficial conversion feature from our convertible notes which matured during the first quarter 2019, and the contingent consideration fair market value adjustment of $11.7 million and working capital and other assets used cash of $2.9 million.

*Investing Activities*

We used cash of $3.7 million in investing activities for the six months ended June 30, 2019 primarily for the purchase of surgical instruments to support the commercial launch of new products.

*Financing Activities*

Financing activities provided cash of $7.8 million for the six months ended June 30, 2019, primarily attributed to the $10.0 million draw from our Squadron expanded credit facility, net of $0.3 million debt discount and $1.4 million from warrant and stock option exercises and purchase of common stock under our employee stock purchase plan. This was offset by principal payments on our term loan totaling $3.0 million and net payments under the lines of credit of $0.3 million.

*Off-Balance Sheet Arrangements*

We do not have any off-balance sheet arrangements.

*Contractual obligations and commercial commitments*

Total contractual obligations and commercial commitments as of June 30, 2019 are summarized in the following table (in thousands):

| | Payment Due by Year | | | | | | |
|---|---|---|---|---|---|---|---|
| | Total | 2019 (remainder) | 2020 | 2021 | 2022 | 2023 | Thereafter |
| Amended Credit Facility with MidCap | $ 11,343 | $ — | $ — | $ — | $ 11,343 | $ — | $ — |
| Inventory financing | 1,825 | — | — | — | — | 1,825 | — |
| Squadron Term Loan | 45,000 | — | — | 4,483 | 7,685 | 32,832 | — |
| Interest expense | 24,580 | 3,261 | 6,509 | 6,375 | 5,646 | 2,789 | — |
| Note payable for software agreements and insurance premiums | 256 | 209 | 47 | — | — | — | — |
| Capital lease obligations | 129 | 18 | 37 | 37 | 37 | — | — |
| Facility lease obligation | 2,954 | 689 | 1,416 | 849 | — | — | — |
| Other operating lease obligations | 641 | 150 | 302 | 189 | — | — | — |
| Litigation settlement obligations, gross (2) | 19,433 | 2,200 | 4,400 | 4,000 | 4,400 | 4,400 | 33 |
| Guaranteed minimum royalty obligations | 5,684 | 781 | 943 | 918 | 918 | 918 | 1,206 |
| License agreement milestones (1) | 2,250 | 700 | 650 | 250 | 450 | — | 200 |
| Total | $ 114,095 | $ 8,008 | $ 14,304 | $ 17,101 | $ 30,479 | $ 42,764 | $ 1,439 |

(1) These commitments represent payments in cash, and are subject to attaining certain sales milestones which we believe are reasonably likely to be achieved beginning in 2019.

(2) Represents gross payments due to Orthotec, LLC pursuant to a Settlement and Release Agreement, dated as of August 13, 2014, by and among the Company and its direct subsidiaries, including Alphatec Spine, Inc., Alphatec Holdings International C.V., Scient'x S.A.S. and Surgiview S.A.S.; HealthpointCapital, LLC, HealthpointCapital Partners, L.P., HealthpointCapital Partners II, L.P., John H. Foster and Mortimer Berkowitz III; and Orthotec, LLC and Patrick Bertranou. In September 2014, the Company and HealthpointCapital entered into an agreement for joint payment of settlement whereby HealthpointCapital is obligated to pay $5 million of the settlement amount, with payments beginning in the fourth quarter of 2020 and continuing through 2021. See Note 12 of our Notes to Condensed Consolidated Financial Statements for further information.

*Real Property Leases*

In January 2016, we entered into a lease agreement (the “Building Lease”) for office, engineering, and research and development space in Carlsbad, California with the lease term through July 31, 2021. Under the Building Lease our monthly rent payable is approximately $105,000 during the first year and increases by approximately $3,000 each year thereafter.

### Recent Accounting Pronouncements

Aside from newly implemented accounting policies related to revenue recognition discussed above under "Critical Accounting Policies and Estimates" and for the changes disclosed in Note 2 to the Notes to Condensed Consolidated Financial Statements (Unaudited) under the heading "Recent Accounting Pronouncements," there have been no new accounting pronouncements or changes to accounting pronouncements during the six months ended June 30, 2019, as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, filed on March 29, 2019.

### Forward Looking Statements

This Quarterly Report on Form 10-Q incorporates a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including statements regarding:

- our estimates regarding anticipated operating losses, future revenue, expenses, cost savings, capital requirements, uses and sources of cash and liquidity, including our anticipated revenue growth and cost savings;
- our ability to meet the financial covenants under our credit facilities;
- our ability to ensure that we have effective disclosure controls and procedures;
- our not realizing the full economic benefit from the Globus Transaction, including as a result of indemnification claims under the definitive agreement and the retention by us of certain liabilities associated with the international business, and our ability to meet our obligations under the Globus supply agreement;
- our ability to meet, and potential liability from not meeting, the payment obligations under the Orthotec settlement agreement;
- our ability to regain and maintain compliance with the quality requirements of the FDA;
- our ability to market, improve, grow, commercialize and achieve market acceptance of any of our products or any product candidates that we are developing or may develop in the future;
- our beliefs about the features, strengths and benefits of our products;
- our ability to successfully achieve and maintain regulatory clearance or approval for our products in applicable jurisdictions and in a timely manner;
- the effect of any existing or future federal, state or international regulations on our ability to effectively conduct our business;
- our estimates of market sizes and anticipated uses of our products;
- our business strategy and our underlying assumptions about market data, demographic trends, reimbursement trends and pricing trends;
- our ability to achieve profitability, and the potential need to raise additional funding;
- our ability to attract and retain a qualified management team, as well as other qualified personnel and advisors;
- our ability to protect our intellectual property, and to not infringe upon the intellectual property of third parties;
- our ability to meet or exceed the industry standard in clinical and legal compliance and corporate governance programs;
- potential liability resulting from litigation;
- potential liability resulting from a governmental review of our business practices;
- our beliefs about the usefulness of the non-GAAP financial measures included in this Quarterly Report on Form 10-Q;
- our beliefs with respect to our critical accounting policies and the reasonableness of our estimates and assumptions; and
- other factors discussed elsewhere in this Quarterly Report on Form 10-Q or any document incorporated by reference herein or therein.

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be wrong. They can be affected by inaccurate assumptions and/or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Quarterly Report on Form 10-Q will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially from expected results.

We also provide a cautionary discussion of risks and uncertainties under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2018 and any updates to those risk factors filed from time to time in our subsequent periodic and current reports filed with the SEC. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed there could also adversely affect us.

Without limiting the foregoing, the words "believe," "anticipate," "plan," "expect," "estimate," "may," "will," "should," "could," "would," "seek," "intend," "continue," "project," and similar expressions are intended to identify forward-looking statements. There are a number of factors and uncertainties that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control, including the factors set forth under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2018 and any updates to those risk factors filed from time to time in our subsequent periodic and current reports filed with the SEC. In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

*Interest Rate Risk*

Other outstanding debt consists of fixed rate instruments, including debt outstanding under the Amended Credit Facility with MidCap and the Globus Facility Agreement, notes payable and capital leases.

Our borrowings under our credit facilities expose us to market risk related to changes in interest rates. As of June 30, 2019, our outstanding floating rate indebtedness totaled $57.6 million. The primary base interest rate is the LIBOR rate. Assuming the outstanding balance on our floating rate indebtedness remains constant over a year, a 100 basis point increase in the interest rate would decrease pre-tax income and cash flow by approximately $0.6 million.

*Commodity Price Risk*

We purchase raw materials that are processed from commodities, such as titanium and stainless steel. These purchases expose us to fluctuations in commodity prices. Given the historical volatility of certain commodity prices, this exposure can impact our product costs. However, because our raw material prices comprise a small portion of our cost of revenues, we have not experienced any material impact on our results of operations from changes in commodity prices. A 10% change in commodity prices would not have had a material impact on our results of operations for the six months ended June 30, 2019.

## Item 4. Controls and Procedures

*Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in our reports that we file or submit pursuant to the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's, or SEC's, rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of the effectiveness of our disclosure controls and procedures (as such term is defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based on such evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, has concluded that our disclosure controls and procedures were not effective at a reasonable assurance level for the interim periods ended and as of June 30, 2018 and September 30, 2018 and as of December 31, 2018. This conclusion was based on the material weakness identified in our internal control over financial reporting related to our lack of sufficient oversight and review to ensure the complete and proper application of U.S. GAAP associated with complex equity transactions. We identified and reported this weakness to the Audit Committee of our Board of Directors. A material weakness existed as of December 31, 2018 that was remediated during the first quarter 2019. All controls were deemed to be functioning effectively as of June 30, 2019.

Remediation of the Material Weakness during the first quarter 2019

This material weakness related to a lack of sufficient oversight and review to ensure the complete and proper application of U.S. GAAP associated with complex equity transactions. To remediate the material weakness described above and to prevent similar deficiencies in the future, we added additional controls and procedures, including:

- Hiring of additional personnel, including an accounting manager and staff accountant, that allows for increased oversight of the accounting and finance processes and additional review of complex and non-routine transactions; and
- Re-design of internal controls to ensure more timely quarterly reviews of technical accounting positions documented by our staff and our independent external technical accounting consultants

However, the material weakness will not be considered fully remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively. Any actions we have taken or may take to remediate these deficiencies are subject to continued management review supported by testing, as well as oversight by the Audit Committee of our Board of Directors.

We cannot assure you that material weaknesses or significant deficiencies will not occur in the future and that we will be able to remediate such weaknesses or deficiencies in a timely manner, which could impair our ability to accurately and timely report our financial position, results of operations or cash flows.

*Changes in Internal Control over Financial Reporting*

Except as described above, there has been no change to our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

***Litigation***

We are and may become involved in various legal proceedings arising from our business activities. While the Company has no material accruals for pending litigation or claims for which accrual amounts are not disclosed in the Company's consolidated financial statements, litigation is inherently unpredictable, and depending on the nature and timing of a proceeding, an unfavorable resolution could materially affect our future consolidated results of operations, cash flows or financial position in a particular period. We assess contingencies to determine the degree of probability and range of possible loss for potential accrual or disclosure in our consolidated financial statements. An estimated loss contingency is accrued in our consolidated financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgments about future events. When evaluating contingencies, we may be unable to provide a meaningful estimate due to a number of factors, including the procedural status of the matter in question, the presence of complex or novel legal theories, and/or the ongoing discovery and development of information important to the matters. In addition, damage amounts claimed in litigation against us may be unsupported, exaggerated or unrelated to reasonably possible outcomes, and as such are not meaningful indicators of our potential liability.

Refer to Note 6 for further information regarding the NuVasive, Inc. litigation.

### Item 1A. Risk Factors

There have been no material changes to the risk factors described under Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2018, filed with the SEC on March 29, 2019.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

### Item 5. Other Information

None.

**Item 6.** **Exhibits**

| Exhibit Number | Exhibit Description |
|---|---|
| 10.1 | Form of Warrant (1) |
| 10.2 | Registration Rights Agreement between Alphatec Holdings Inc. and Squadron Medical Finance Solutions LLC and Tawani Holdings LLC, dated June 21, 2019 (2) |
| 10.3 | Third Amendment to the Amended and Restated 2016 Equity Incentive Award Plan (3) |
| 10.4 | First Amendment to the Amended and Restated 2007 Employee Stock Purchase Plan (4) |
| 10.5 | Fifth Amendment to the 2016 Employee Inducement Awards Plan (5) |
| 31.1 | Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | The following materials from the Alphatec Holdings, Inc. Quarterly Report on Form 10-Q for the Three and Six months ended June 30, 2019, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets (Unaudited) as of June 30, 2019 and December 31, 2018, (ii) Condensed Consolidated Statements of Operations (Unaudited) for the Three and Six Months Ended June 30, 2019 and 2018, (iii) Condensed Consolidated Statements of Comprehensive Loss (Unaudited) for the Three and Six Months Ended June 30, 2019 and 2018, (iv) Condensed Consolidated Statements of Stockholders' Equity (Unaudited) for the Three and Six Months Ended June 30, 2019 and 2018 (v) Condensed Consolidated Statements of Cash Flows (Unaudited) for Six Months Ended June 30, 2019 and 2018, and (vi) Notes to Condensed Consolidated Financial Statements (Unaudited). |

(1) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on June 27, 2019
(2) Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed with the SEC on June 27, 2019
(3) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on June 13, 2019
(4) Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed with the SEC on June 13, 2019
(5) Incorporated by reference to Exhibit 10.11 to the Company's Form S-8 filed with the SEC on July 16, 2019

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ALPHATEC HOLDINGS, INC.

By: /s/ Patrick S. Miles
Patrick S. Miles
Chairman and Chief Executive Officer
(principal executive officer)

By: /s/ Jeffrey G. Black
Jeffrey G. Black
Executive Vice President and Chief Financial Officer
(principal financial officer and principal accounting officer)

Date: July 26, 2019

**Exhibit 31.1**

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**
**PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Patrick S. Miles, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Alphatec Holdings, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Patrick S. Miles
Patrick S. Miles
Chairman and Chief Executive Officer
(principal executive officer)
July 26, 2019

**Exhibit 31.2**

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**
**PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Jeffrey G. Black, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Alphatec Holdings, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Jeffrey G. Black
Jeffrey G. Black
Chief Financial Officer
(principal financial and accounting officer)
July 26, 2019

**Exhibit 32**

**CERTIFICATION UNDER**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Alphatec Holdings, Inc. (the "Company") on Form 10-Q for the quarterly period ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Patrick S. Miles, Chairman and Chief Executive Officer, certify, to my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: July 26, 2019

/s/ Patrick S. Miles
Patrick S. Miles
Chairman and Chief Executive Officer
(principal executive officer of the Company)

In connection with the Quarterly Report of Alphatec Holdings, Inc. (the "Company") on Form 10-Q for the quarterly period ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jeffery G. Black, Chief Financial Officer, certify, to my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: July 26, 2019

/s/ Jeffrey G. Black
Jeffrey G. Black
Chief Financial Officer
(principal financial and accounting officer of the Company)